THE 18-MONTH FORECAST: SURPRISING HELP FROM THE CRASH

JANUARY 18, 1988 $3.50

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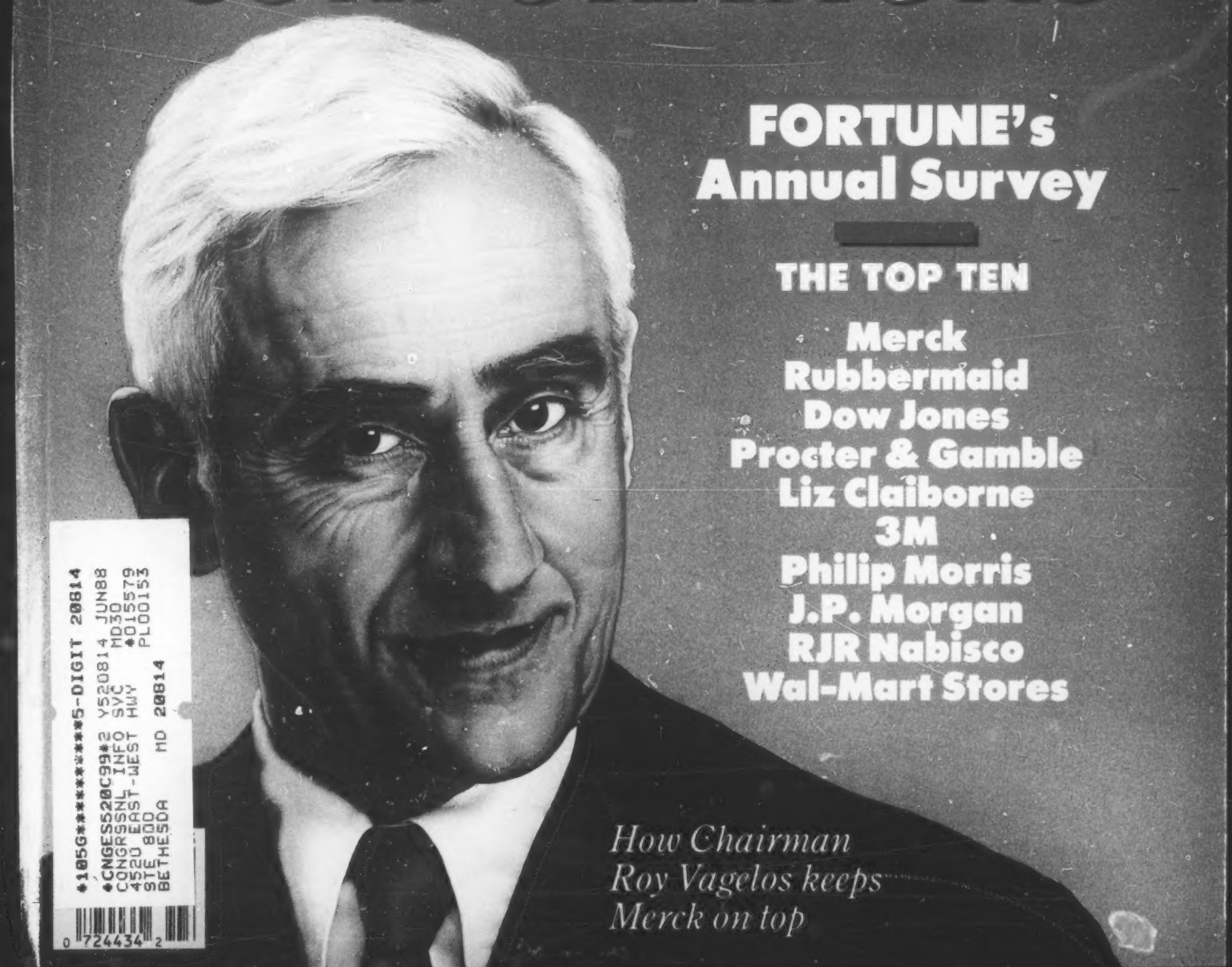
AMERICA'S MOST ADMIRED CORPORATIONS



FORTUNE's Annual Survey

THE TOP TEN

Merck
Rubbermaid
Dow Jones
Procter & Gamble
Liz Claiborne
3M
Philip Morris
J.P. Morgan
RJR Nabisco
Wal-Mart Stores

How Chairman Roy Vagelos keeps Merck on top

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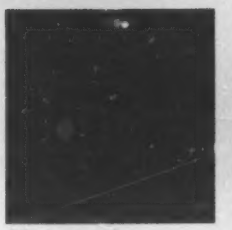
JANUARY 18, 1988 VOL. 117, NO. 2

FORTUNE

"Up until this year, let's face it, we were managing for survival."

PAGE 38



"In terms of management development, UPS is up there with IBM."

PAGE 56

"There is a simple method that indicates when an investment is turning up. All you have to do is sit down with a chart book . . ."

PAGE 101

"I think anybody who is black and has had a job in America has encountered racism in some form."

PAGE 109

By word and example he convinced the U.S. all over again that it is a "can do" country.

PAGE 124

"Oh yes, the corporate spirit. How much is it worth on the balance sheet? Sharp-pencil types may scoff. They shouldn't."

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Merck is No. 1 for the second year in a row—and IBM falls out of the magic circle. *by Ellen Schultz*

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THE EDITOR'S DESK

ANDY FREEBERG (2)

FORTUNE's *Todd May and Vivian Brownstein see good economic news ahead.*

HOW'S BUSINESS going to be in 1988? Replies FORTUNE's chief economist Todd May: "Surprisingly good." While most economists are predicting a 2% increase in the gross national product, our call is 2.3%. May sees the fallen dollar and strong capital spending shoring up the economy. At the same time, "inflation won't spurt much and profits will improve." For the details, see FORTUNE's 18-month forecast on page 68.

Reporter Schultz

A year ago, FORTUNE predicted that the U.S. economy in 1987 would grow 2.1%; it now looks as if the figure will be 2.8%. As for inflation, we foresaw a 3.4% rise in the GNP deflator; the actual number appears to be 3%. For three straight years, FORTUNE's economists have been more accurate than the Blue Chip consensus, a group of some 50 distinguished professional forecasters. May is one of them.

FORTUNE is the only U.S. business publication to make its *own* economic forecasts. May and associate economist Vivian Brownstein use an econometric model, drawing on thousands of government and private statistics. This helps them discern the emerging patterns and predict the course of the economy and its specific sectors. Says Charles Burck, who edits the Economy section: "Todd brings the wisdom of a seasoned and skeptical observer to the process. He is unmatched at picking out the faint sounds of a trend from the statistical noise and monthly data."

Another of FORTUNE's unique features is our annual survey of Corporate Reputations. Reporter Ellen Schultz spent six months on the project. She pulled together the lists of 8,000 corporate managers, directors, and analysts who were queried for the survey, then evaluated the results and wrote our cover story. Her conclusion: "Over the long haul, the companies with the best reputations tend to have the highest total returns to their shareholders." Before we went to press, Schultz got many calls from executives and business professors eager to learn the survey results. They—and you—now can get them by turning to page 32.

Marshall Loeb

MANAGING EDITOR

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AMERICA'S MOST ADMIRED CORPORATIONS

Merck is No. 1 for the second year in a row, IBM falls out of the magic circle to No. 32, and two tobacco companies make it into the top ten for the first time. ■ *by Ellen Schultz*

THE PLAUDITS keep coming for the champ of the medical molecule makers. In a stunning demonstration of managerial excellence, Merck & Co. has earned the title of America's most admired corporation for the second year in a row. Rating 306 major corporations, executives, directors, and financial analysts surveyed by FORTUNE ranked Merck first in seven of eight measures ranging from innovativeness to quality of products to long-term investment value. IBM, which reigned as most admired for four years before being ousted by Merck, seems bent on demonstrating the adage about the bigger they come the harder they fall. Big Blue slipped to No. 8 last year and then went down for the count, sliding all the way to No. 32.

Earning nine points out of a possible ten, Merck won the highest overall rating ever in the six years the survey has been conducted. Thanks to the healthy performance of the company's cardiovascular drugs and antibiotics—plus the September roll-out of a new cholesterol fighter called Mevacor—Merck's projected 1987 sales will climb 20% and profits 30%. Said a survey respondent: "Merck is in the forefront of science, driven to innovate." (For how Chairman Roy Vagelos plans to keep Merck in the forefront, see page 38.)

Big Blue's decline reflects two years of disappointing profits. Fading demand for its mainframes and increasing competition from other manufacturers of personal computers and minicomputers have left IBM a little groggy. But Chairman John Ackers isn't throwing in the towel. "Following two difficult years for us, I'm not surprised by the survey's results," he says. "But IBM's employees have made tremendous progress in transforming us into a sharper, more competitive company."

By reputation, IBM remains a bastion of financial soundness (it ranks No. 4), but scored in the bottom half of the companies surveyed on innovativeness (No. 158). That may seem odd: IBM physicists have won Nobel Prizes two years running, in 1986 for the development of an atomic microscope and in 1987 for a major breakthrough in superconductivity. But IBM is not a technological leader in the marketplace, preferring to let competitors assume that risky role. In 1987, however, the company successfully launched a new line of personal computers and was the first to mass-produce megabit memory chips. Says Ackers: "Our challenge is to do even more to enhance IBM's business results."

To this end he has boosted his worldwide sales force by nearly 11,000 people, redeploying many of them from corporate headquarters, in hopes of beating back the challenge from such competitors as Digital Equipment. While it's too soon to tell how successful Ackers will be in resuscitating profits, some survey respondents think IBM's troubles are temporary. Says one: "Present management is not to blame. The current strategy is probably far more astute than current profits would suggest."

HOW IT WAS DONE

■ FORTUNE polled more than 8,000 top executives, outside directors, and financial analysts for the sixth annual Corporate Reputations Survey. They were asked to rate the ten largest companies in their own industries—analysts ranked concerns in the industry they follow—on eight key attributes: quality of management, quality of products or services, innovativeness, long-term investment value, financial soundness, community and environmental responsibility, use of corporate assets, and ability to attract, develop, and keep talented people. Ratings are on a scale of 0 (poor) to 10 (excellent). Some 3,480 people responded to the survey, and 90% of the returns were in hand before the stock market crashed on October 19.

The survey covers companies that appear in the annual FORTUNE 500 and FORTUNE Service 500 directories. Companies are assigned to one of 33 industries according to the business that contributed most to their 1986 sales (or, in the case of financial companies, the largest share of their assets). Some industries have fewer than ten companies, but to appear in the survey an industry group had to have at least four. A total of 306 companies were included in the survey.

ILLUSTRATIONS BY ANDERS WENNGREN

AT THE TOP & BOTTOM OF THE 306 COMPANIES

RANK	COMPANY	SCORE
1	**Merck** Pharmaceuticals	9.00
2	**Rubbermaid** Rubber products	8.29
3	**Dow Jones** Publishing, printing	8.24
4	**Procter & Gamble** Soaps, cosmetics	8.15
5	**Liz Claiborne** Apparel	8.14
6	**3M** Scientific/photographic equip.	8.10
7	**Philip Morris** Tobacco	8.07
8	**J.P. Morgan & Co.** Commercial banking	8.03
9	**RJR Nabisco** Tobacco	7.90
10	**Wal-Mart Stores** Retailing	7.90

The most admired

An old friend is missing—IBM. For the first time it is out of the top ten. RJR Nabisco and Wal-Mart, both newcomers to the list, tied for ninth place.

RANK	COMPANY	SCORE
306	**Financial Corp. of Amer.** Savings institutions	2.62
305	**American Motors** Motor vehicles and parts	3.05
304	**BankAmerica** Commercial banking	3.21
303	**LTV** Metals	3.24
302	**Bethlehem Steel** Metals	3.69
301	**Texas Air** Transportation	4.00
300	**Manville** Glass, building materials	4.14
299	**Kaiser Alum. & Chem.** Metals	4.19
298	**Control Data** Computers (and office equip.)	4.32
297	**Coleco Industries** Toys, sporting goods	4.34

The least admired

Perception may not square with reality in the case of Control Data and Bethlehem, but the other cellar dwellers have good reason for being in the dark.

Concludes another: "IBM will catch up."

Rubbermaid occupies the No. 2 spot, up from fifth place in the previous survey. When he became chairman in 1980, Stanley Gault set a goal of 15% annual increases in sales, which the company has met in each of the past five years. In 1987 sales are projected to be up 16% and earnings 20%. Ranked third overall for both quality of management and innovativeness, Rubbermaid continues to roll out 100 new products a year, including office supplies, patio furniture, and toys. Says Gault: "Our objective is to have at least 30% of our sales in any given year come from products that have been introduced within the last five years."

Back up to No. 3 after slipping to ninth place in the last survey, Dow Jones, publisher of the *Wall Street Journal* and *Barron's*, was rated third overall in value as a long-term investment. Although national advertising linage was down 2% from 1986, reflecting a slump that affected the entire publishing industry, demand for the Dow Jones information services has increased, and company earnings are expected to rise 15%.

A shape-up diet helped Procter & Gamble fit into fourth place (up from 18th a year ago). P&G cut the fat from its shortening and cooking-oil business by closing four of its seven plants, and then it burned off some calories by killing the unprofitable Duncan Hines soft-cookie line. Three powdered-detergent facilities fell victim to the company's decision to put heavier emphasis on liquid detergents. Security analysts were also smacking their lips over the prospect that Olestra—P&G's synthetic fat substitute that is expected to do for fat what NutraSweet did for sugar—is within two years of reaching the market.

Liz Claiborne's descent to No. 5 (from No. 2) reflects tougher competition rather than a decline in reputation. Its scores in most categories were light-years ahead of those of its competitors. The reason Liz Claiborne has done so well, says the eponymous founder: "Plain, good old-fashioned hard work."

Last seen in the top ten in 1985, 3M has made its reputation for innovative products stick with Scotch tape and Post-it notes. Although the company's videotape and floppy-disk businesses are still losing money in worldwide price wars, 3M has managed an estimated 18% earnings increase in 1987. Help came from cost controls—3M chopped some 3,700 jobs in 1986—and such products as a new Scotch-guard process for carpets.

As it always has, J.P. Morgan ran ahead of the pack in banking. Like other banks, Morgan was forced to increase its reserves to cover Latin American loans, and that $875 million hit to the income statement produced the bank's first yearly loss since it went public in 1959. While security analysts fret about the soundness of other banks, Morgan is considered rock solid. "Everything that it does remains of the highest caliber," says Richard Fredericks, an analyst at Montgomery Securities. "This extends to lending practices, balance sheet integrity, and backroom operations."

TWO TOBACCO companies, Philip Morris and RJR Nabisco, made it into the top ten, an impressive achievement considering that their chief product cannot be sold without a warning from the U.S. Surgeon General that cigarette smoking causes cancer, heart disease, and emphysema. To compensate for fewer smokers, both companies have been diversifying into other businesses and turning out new types of cigarettes and brands to lure consumers from competitors. Philip Morris's Benson & Hedges now comes in nine varieties. Although the white male smoker, once the industry's mainstay, is vanishing, Philip Morris and RJR aggressively court such other segments of the market as women and blacks. Together the two companies account for nearly 70% of the $32-billion-a-year U.S. tobacco market.

Wal-Mart Stores, new to the survey this year because it is now among the ten largest retailers, shot straight to tenth place. In a flat season for retailers, Wal-Mart aggressively cut prices to spur sales and increase market share. Results: A 23% rise in earnings is projected for 1987. Writes a fan: "Wal-Mart represents the absolute best of American capitalism. It makes me feel encouraged about the U.S. and its ability to compete."

The companies held in highest esteem by survey respondents tend to be admired by investors too. That was borne out last year in the October 19 great crash (see table, left). From the beginning of 1987 to December 11, the median total return to shareholders (dividends plus capital gains or losses)

TWENTY STOCKS TOSSED IN THE STORM

The most admired companies came through the market crash like the champions they are. October 14 was selected as a benchmark because it was the day before the start of the staggering 769-point decline. American Motors was sold to Chrysler in August and missed the cataclysm.

Most admired

Percent change in total return to investors

	Precrash Jan 2–Oct. 14	Post-crash Oct. 14–Dec. 11	Total to date
Merck	+55.9	−17.5	+28.9
Rubbermaid	+13.6	−18.0	−6.6
Dow Jones	+3.8	−22.7	−19.5
Procter & Gamble	+25.7	−10.5	+12.9
Liz Claiborne	+19.9	−48.0	−37.5
3M	+27.6	−15.4	+7.6
Philip Morris	+57.0	−18.1	+29.3
J.P. Morgan	+12.2	−30.1	−20.9
RJR Nabisco	+28.5	−23.8	−1.5
Wal-Mart	+47.7	−32.4	0.0

Least admired

Percent change in total return to investors

	Precrash Jan 2–Oct. 14	Post-crash Oct. 14–Dec. 11	Total to date
Financial Corp.	−65.0	−38.1	−78.3
American Motors	N.A.	N.A.	N.A.
BankAmerica	−21.4	−35.9	−49.6
LTV	+130.8	−36.7	+46.2
Bethlehem	+188.0	−9.7	+160.0
Texas Air	−28.5	−56.5	−68.9
Manville	+66.7	−28.0	+20.0
Kaiser Aluminum	+45.0	−50.9	−28.8
Control Data	+31.8	−45.3	−28.0
Coleco	−1.5	−50.0	−50.7

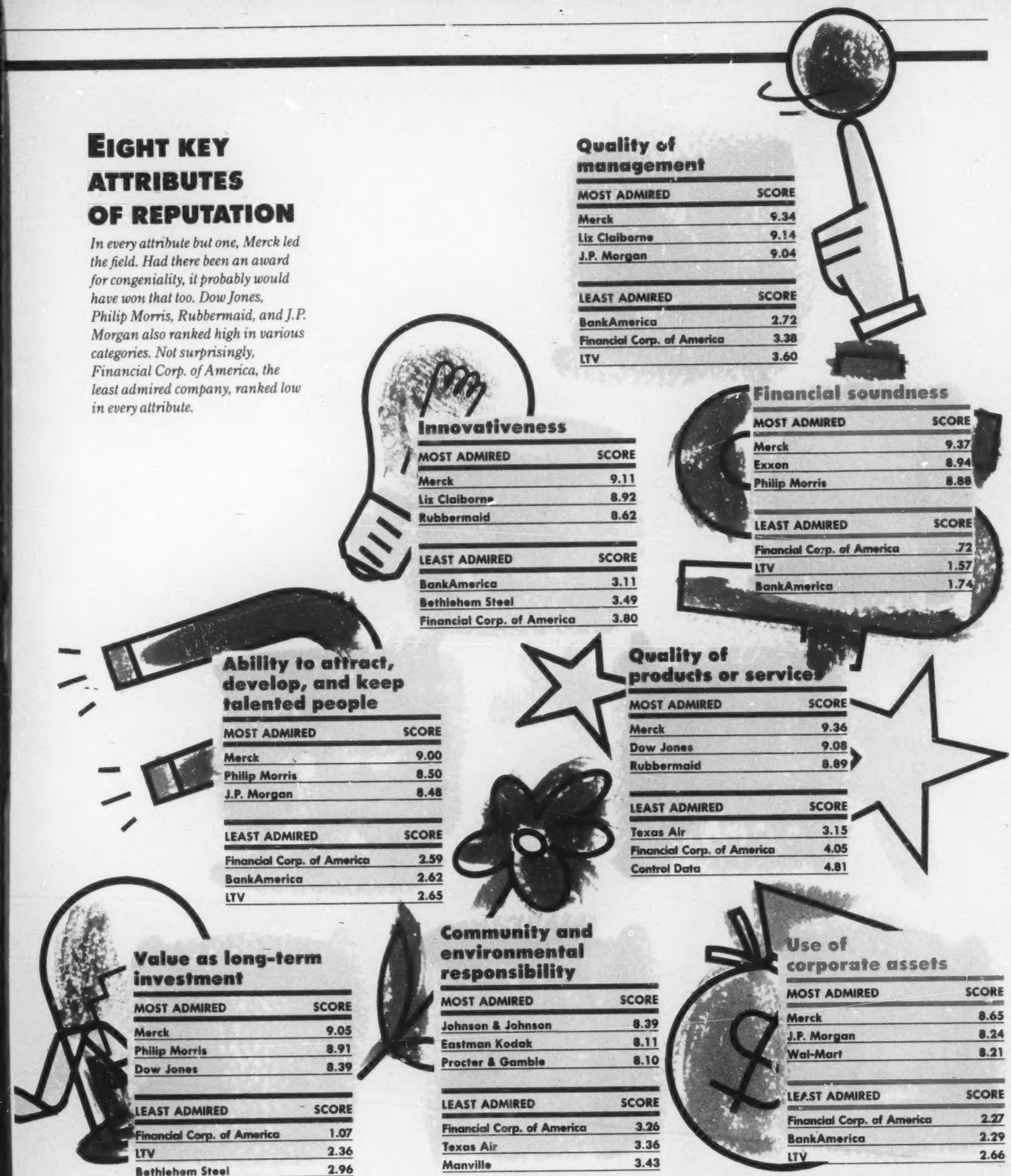
Median returns

Percent change

	Precrash Jan 2–Oct. 14	Post-crash Oct. 14–Dec. 11	Total to date
Most admired	26.2	−20.4	−0.8
Least admired	+31.8	−38.1	−28.8
All companies	+25.7	−26.6	−5.9
S&P 500	+23.8	−22.9	−4.5

EIGHT KEY ATTRIBUTES OF REPUTATION

In every attribute but one, Merck led the field. Had there been an award for congeniality, it probably would have won that too. Dow Jones, Philip Morris, Rubbermaid, and J.P. Morgan also ranked high in various categories. Not surprisingly, Financial Corp. of America, the least admired company, ranked low in every attribute.



Quality of management

MOST ADMIRED	SCORE
Merck	9.34
Liz Claiborne	9.14
J.P. Morgan	9.04

LEAST ADMIRED	SCORE
BankAmerica	2.72
Financial Corp. of America	3.38
LTV	3.60

Innovativeness

MOST ADMIRED	SCORE
Merck	9.11
Liz Claiborne	8.92
Rubbermaid	8.62

LEAST ADMIRED	SCORE
BankAmerica	3.11
Bethlehem Steel	3.49
Financial Corp. of America	3.80

Financial soundness

MOST ADMIRED	SCORE
Merck	9.37
Exxon	8.94
Philip Morris	8.88

LEAST ADMIRED	SCORE
Financial Corp. of America	.72
LTV	1.57
BankAmerica	1.74

Ability to attract, develop, and keep talented people

MOST ADMIRED	SCORE
Merck	9.00
Philip Morris	8.50
J.P. Morgan	8.48

LEAST ADMIRED	SCORE
Financial Corp. of America	2.59
BankAmerica	2.62
LTV	2.65

Quality of products or services

MOST ADMIRED	SCORE
Merck	9.36
Dow Jones	9.08
Rubbermaid	8.89

LEAST ADMIRED	SCORE
Texas Air	3.15
Financial Corp. of America	4.05
Control Data	4.81

Value as long-term investment

MOST ADMIRED	SCORE
Merck	9.05
Philip Morris	8.91
Dow Jones	8.39

LEAST ADMIRED	SCORE
Financial Corp. of America	1.07
LTV	2.36
Bethlehem Steel	2.96

Community and environmental responsibility

MOST ADMIRED	SCORE
Johnson & Johnson	8.39
Eastman Kodak	8.11
Procter & Gamble	8.10

LEAST ADMIRED	SCORE
Financial Corp. of America	3.26
Texas Air	3.36
Manville	3.43

Use of corporate assets

MOST ADMIRED	SCORE
Merck	8.65
J.P. Morgan	8.24
Wal-Mart	8.21

LEAST ADMIRED	SCORE
Financial Corp. of America	2.27
BankAmerica	2.29
LTV	2.66

for all 306 companies surveyed fell 5.9%. By contrast, the median loss for the ten most admired companies came to less than 1%, and the loss for the ten least admired hit a wallet-thinning 28.8%.

Financial Corp. of America was the absolute least admired company, ranking No. 306, and its stock market decline of 78% to December 11 was the largest of the denizens of the deep ten. An avalanche of loan-loss provisions has almost buried shareholders' hopes of seeing the nation's largest savings and loan get back on its feet. As of mid-December the Federal Home Loan Bank Board had been unable to unload this distressed merchandise—Ford Motor appears to be the only willing buyer—and FCA may have to be declared insolvent.

American Motors (No. 305) has been absorbed by Chrysler, and BankAmerica (No. 304) might soon need a wealthy buyer itself. Although Chairman A. W. Clausen promised to turn the company around, he has not yet made good on his word. Even with the ongoing fire sale of subsidiaries and divisions, the bank faces a $915 million loss in 1987.

Thanks to the boom in the steel industry, bankrupt LTV (No. 303) and Bethlehem Steel (No. 302) have begun to breathe again. After five years a slimmer, trimmer Bethlehem is back in the black, and Chairman Walter F. Williams insists his company, whose stock more than doubled in the last year despite the crash, doesn't deserve its bad reputation (see page 39). LTV put three-quarters of operating profits together for the first time since 1983, but has so far failed in its attempt to dump $2.2 billion of unfunded pension liabilities on the government.

AS A RESULT of Chief Executive Frank Lorenzo's voracious acquiring, Texas Air (No. 301) grew large enough to be included in the survey—and promptly crash-landed in the bottom ten. The parent of Eastern and Continental airlines, both criticized for late arrivals, dirty planes, and lost baggage, Texas Air ranks worst of all 306 companies in quality of products and service.

Though recovering financially, Manville (No. 300) is still remembered as the insensitive maker of asbestos. With rising aluminum prices and corporate cost cutting, Kaiser Aluminum & Chemical (No. 299) earned its first quarterly profits in two years but is saddled with huge debts. Control Data's No. 298 ranking does not yet reflect the company's strenuous efforts to sell assets, realign management, and secure long-term financing. At Coleco Industries (No. 297) the company's good repute has vanished like the fickle young customers who cooled on Cabbage Patch dolls. Coleco's attempts to broaden its base to include board games such as Scrabble and Trivial Pursuit have not paid off yet, and the toymaker lost money in two quarters.

Where a corporation ranks on the survey depends to some extent on how well its industry is perceived. An important court ruling that tobacco companies could not be sued on the grounds that the warning label on the package is inadequate improved their already rosy outlook and blew the scores of all four competitors smoke-ring high. Writes a respondent: "These companies are among the real money machines of America." Several corporations whose reputations improved most during the year—Amax, USX, Dow Chemical, and Union Carbide among them—are in industries benefiting from major restructuring, the dive of the dollar, and rising demand.

The reputation of Allegis, whose new name does not quite conceal its old identity as the loss tossed United Airlines, fell further than any other company—from No. 188 to No. 290. Granted, the airline business has been dismal, but Allegis also has itself to blame. Last spring the board finally forced the resignation of Chief Executive Richard J. Ferris, who it felt was not moving fast enough to turn the company around.

Once sullied, a good reputation is hard to win back. One of Shakespeare's characters said it best: "He that filches from me my good name robs me of that which not enriches him, and makes me poor indeed." The speaker? The villain Iago.

THOSE THAT DID BETTER—AND WORSE

Companies whose scores rose the most tended to be in industries finally benefiting from the hard and painful work of restructuring. The ones that fell from grace, however, did so for a variety of reasons, among them: poor management, earnings declines, and shaky balance sheets.

Biggest gains over last year

COMPANY	SCORE	CHANGE	PERCENT
Harsco	7.04	+1.05	17.5
International Flavors & Fragrances	7.30	+.77	11.7
Honeywell	6.22	+.75	13.7
Cooper Tire & Rubber	6.76	+.73	12.1
Amax	5.10	+.69	15.6
USX	5.18	+.68	15.1
Colgate-Palmolive	6.98	+.63	9.9
Merck	9.00	+.62	7.3
Union Carbide	4.77	+.61	14.6
Dow Chemical	7.53	+.60	8.6

Biggest losses over last year

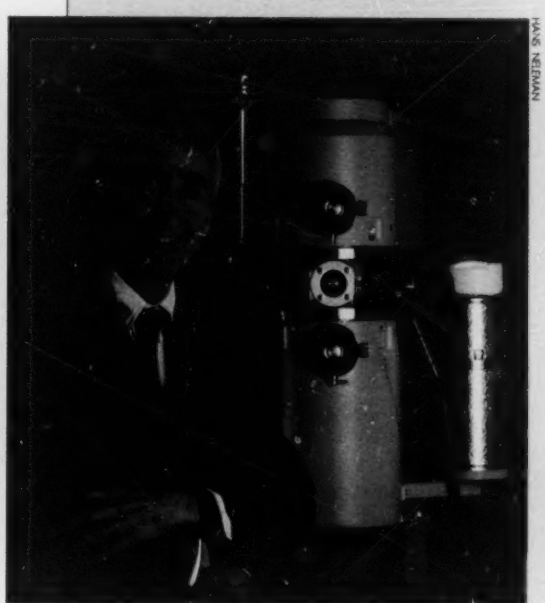
COMPANY	SCORE	CHANGE	PERCENT
Allegis	4.70	−1.74	−27.0
Collins & Aikman	6.33	−1.34	−17.4
Burlington	4.82	−1.24	−20.4
General Motors	5.43	−1.13	−17.2
Hon Industries	6.33	−1.02	−13.8
Financial Corp.	2.62	−.84	−24.2
Wang	4.82	−.77	−13.7
Southland	5.24	−.72	−12.0
Leggett & Platt	7.07	−.65	−8.4
Chemical New York	5.41	−.65	−10.7

LET'S HEAR IT FROM THE WINNER— AND FROM A LOSER

THINK YOU had a good year? Merck just wrapped up 12 months in which sales are projected to increase over 20% to $5 billion and earnings more than 30% to $900 million. Behind those numbers are some new wonder drugs the company launched in the past two years, including Mevacor, which lowers cholesterol levels in the blood; Vasotec, a treatment for hypertension and congestive heart failure; and Primaxin and Noroxin, new antibiotics. So what's next? FORTUNE's Bill Saporito put that question to the ever anxious Dr. P. Roy Vagelos, the company's chairman, when he caught up with him at the Merck Sharp & Dohme division in West Point, Pennsylvania.

You've been No. 1 for two years in a row. How long can you keep it up?

I think Merck is a very competitive company, and I push our people to be competitive. We would like to be No. 1 forever. We had a hell of a year in 1987—unbelievable. Our job is to deliver that in 1988.



HANS NEEMAN

Vagelos asks: What have you done for me lately?

What's so great about being No. 1?

Last year it was a wonderful compliment. It did great things for the morale of the company and for our recruiting, because Merck is not a familiar corporate name. Now we are recognized on campuses, so our recruiting results have been just super. We have superstars hanging from the ceiling in most areas, and I'll be happy only when we have them hanging from every area of our organization.

What will you tell the troops about your rating in this survey?

I'll tell them it probably wasn't an accident last year.

So what do you do after that?

I still am anxious about what the next thing is going to be. The only way to alleviate my anxiety is to be busy on what I think is important. About two months after filing with the FDA for Mevacor, we filed our next new drug application for Zocor, another agent for reducing cholesterol, which, of course, is the strategy. While other people are talking about all the drugs they are making, we're in there with a second one. I like that.

Sounds like a religion.

It's not a religion at all. It's understanding that the most important thing you can contribute as a human being is improving the lives of millions of people. We do that every year, introducing drugs and vaccines that will change the course of diseases or prevent diseases. And what could be better than that?

Are you afraid some of your folks will coast?

The trick is not doing it one year or two years. The trick is to take advantage of the fact that we have numerous new products doing well to lay the foundation for long-term growth of the corporation. Pharmaceuticals is a very fragmented market, and a company that can put everything together for a series of years should be able to gather up a much larger and more significant share of the market. There are plenty of diseases left.

Pardon the expression, but how do you keep that fire in the belly?

I'll tell you how we do it. We have scientists, and we have objectives. The objectives are to do something about a disease, and so we assign that task to people who are willing to take it on. It's a very high-risk business. We recognize that most of the research we do and most of the drugs we come up with will fail. But we challenge people to get into new fields, and we tell them that the objective is to make a drug, not just to discover facts and publish in trade journals.

And once they do make a drug?

The fact that we have a new antibiotic like Primaxin is terrific for the people who are working on antibiotics. But what about the guys who are working on a pulmonary disease? You don't relax, because you recognize that triumph in one field only helps people afflicted by that particular ailment. I make it very clear that making a new drug for glaucoma is not helping the people working on heart disease.

Are sales and earnings going to slow down next year?

Among our 100-plus prescription drugs, in 1986 we had eight that each produced $100 million a year in sales; in 1987 we had 13 that did $100 million each. Many of our new drugs are just beginning their growth cycle. Mevacor was just introduced. Vasotec, Pepcid, for peptic ulcers, and Noroxin are relatively new, and our recombinant hepatitis B vaccine just went on the market.

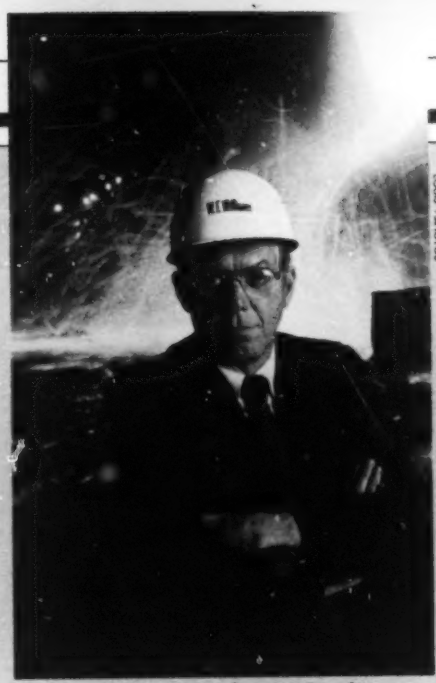
What's on the horizon?

We are beginning clinical trials on a drug that will shrink the prostate gland without debilitating side effects. It may fail, either because it's not effective enough or because it is unsafe. But if it should succeed, I think we would have something just as important as Tagamet [SmithKline Beckman's phenomenally successful ulcer drug]. The incidence of an enlarged prostate in older men is more common than the incidence of ulcers.

Do you enjoy the same high reputation internationally as in the U.S.?

We are No. 1 in market share in the United States, Australia, and Canada. We are very strong in most major markets, but we would like to be in the top two or three everywhere in the world, and we are not yet.

HOW DOES IT FEEL to have led your company through a huge financial turnaround and still be stuck with one of the worst reputations in American industry? Put yourself in the shoes of Walter F. Williams, chief executive of Bethlehem Steel. Bethlehem ranks 302nd out of 306 companies in the Corporate Reputations Survey, and respondents believe the steelmaker has one foot in a blast furnace and the other on a banana peel. For the five years ended in 1986, it lost $2 billion, a hemorrhage that would be fatal to most companies. Then, in 1987, the company finally started producing profits and has enough orders on hand to remain profitable through 1988's first quarter. Williams told Bill Saporito how he felt about Bessie's unenviable reputation.



LOUIS PSIHOYOS

Williams gets back to basics—and profits.

Does Bethlehem deserve its ranking in the survey?

I don't think the steel industry has received anywhere near the credit it deserves for the improvements it has made in the past two years, although the financial community is starting to recognize the strides we've taken. Bethlehem has done as much as anyone in the industry to reduce costs, improve productivity, and make needed capital expenditures. Yet we still can't change the perception that we are a poorly run company.

What kind of things have you done?

We have reduced our operating costs per ton of basic steel products by over $130 a ton to about $400, and we are still cutting costs. In the past five years our productivity has almost doubled in tons per plant employee.

The company is viewed as mired in outdated production techniques, and it ranks only 304th for innovativeness.

You've got to wonder what people think innovation means. We have spent over $2 billion in modernization since 1981 and put in two new, big continuous casters so that 80% of our flat-rolled steel is continuously cast, up from 23% in 1982. Now to me that's innovation. I might point out that in the late Seventies we had a list of a dozen major projects that we knew we had to complete to be competitive in the 1990s. They included such things as the new blast furnaces at Sparrows Point in Baltimore; a caster for the rail mill at Steelton, Pennsylvania; the two big slab casters at Sparrows Point and Burns Harbor; and the modernization of a structural mill at Bethlehem. We have accomplished all of those in spite of our difficulties.

Is there any money left?

We have well over $500 million in cash and securities, and we have just picked up another $186 million from a public stock offering. We also have some $200 million in cash tied up in collateral, so if you add it all together, at the end of November we had close to a billion dollars in the till.

So you've satisfied all the critics?

Well, put it this way: The perception among the analysts is that we should be more profitable. We will have both an operating profit and a net profit in the fourth quarter that, with the first three quarters, will make us profitable for 1987. Look at the first three quarters of 1987 vs. the first three quarters of 1986; the income from steel operations alone has improved by some $230 million.

What about 1988?

The underlying economy, despite the stock market crash, is still very solid. There is a lot of pent-up demand from our machinery and construction customers. There may be a slight fall in automotive demand, but it won't be significant, so there's no reason we shouldn't have a pretty good year.

Have the employees recognized the company's improving health?

What we are doing is working. There's nothing that does as much good for a company as for its people to see the results of their efforts. We have a much smaller company, with half the employees we had six years ago. Our management and supervisory groups are much leaner, and we have been trying to push responsibility and authority down as far as possible—which I suppose everyone else is trying to do too. Our employees understand our problems, and they think we are trying to do the right things to enhance the quality of our steel. I hear quality mentioned all the time.

Even the union folks feel this way?

I have to give a lot of credit to our steel workers. They have entered into two concessionary contracts, one in 1983 and one in 1986. Our shutdowns and cutbacks hurt a lot of people, but our production workers have responded well to many of our offers for retraining, to implementing Statistical Process Control, and to our quality programs.

Is managing a company that's had serious problems very different from managing a profitable one?

Well, I could say this: Up until this year, let's face it, we were managing for survival. Our focus was on liquidity and cash flow, and that certainly was a difficult period in which to manage. We are still concerned about making sure we have adequate liquidity, but this year is a pleasant change. We are managing for profit, and I think that is a big difference. We still have further restructuring to do to improve our liquidity, but the focus now is on improving our profit.

You mentioned that the financial community has begun to recognize your hard work. How far along are you in changing the perception of Bessie?

Not only Bethlehem but the whole steel industry has to communicate our story better to the public and to our employees: that we are getting our act straightened out and that we have come a long way. We can't say we've solved all our problems because I'm not so sure all the problems of the American industrial base have been solved at this point, and we're part of that. We have an educational program to do to let people know how we have improved our quality. I believe our steel in our market is now as good as, or superior to, any in the world.

How COMPANIES RANK IN 33 INDUSTRIES

Industry groups are based on U.S. Office of Management and Budget categories. Companies are assigned to industries according to the business that contributed most to 1986 sales.

Aerospace

Boeing, still first in its industry, fell out of the top ten this year; scores of all the aerospace companies sank.

RANK	LAST YEAR	COMPANY	SCORE
1	1	Boeing	7.70
2	2	Martin Marietta	6.99
3	3	Rockwell International	6.76
4	4	Lockheed	6.61
5	6	McDonnell Douglas	6.54
6	7	United Technologies	6.27
7	8	General Dynamics	6.25
8	5	Northrop	6.19
9	9	Textron	5.77
10	10	Allied-Signal	5.71

Beverages

Pepsi dethroned Coke in the ongoing competition of the colas, while Coors traded places with Seagram.

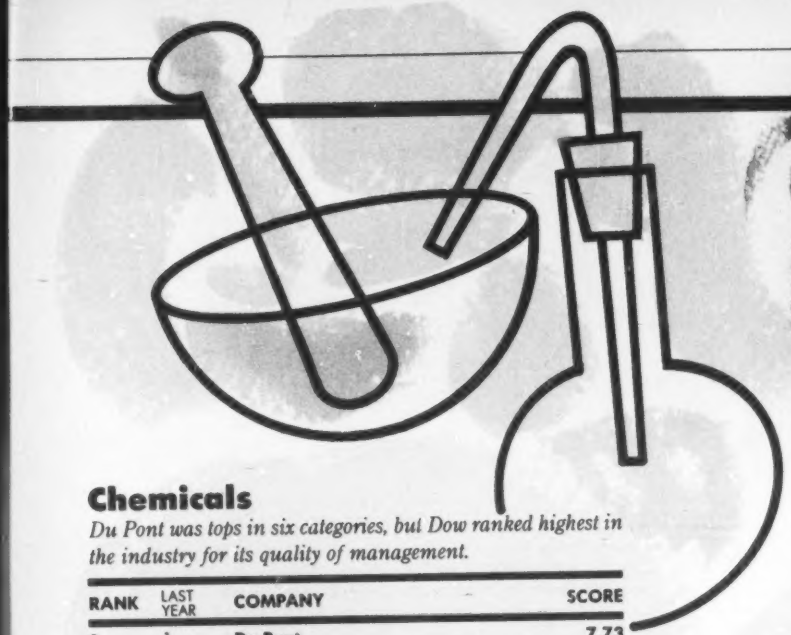
RANK	LAST YEAR	COMPANY	SCORE
1	2	PepsiCo	7.82
2	3	Anheuser-Busch	7.53
3	1	Coca-Cola	7.47
4	4	General Cinema	5.79
5	6	Adolph Coors	5.76
6	5	Joseph E. Seagram & Sons	5.69
7	7	Brown-Forman	5.60
8	8	G. Heileman Brewing	5.00

Apparel

Liz Claiborne sports the fanciest score, while Farley/Northwest fell when it switched industries.

RANK	LAST YEAR	COMPANY	SCORE
1	1	Liz Claiborne	8.14
2	2	VF	7.48
3	3	Hartmarx	6.27
4	5	Kellwood	6.09
5	4	Interco	6.05
6	6	Oxford Industries	5.68
7	7	Phillips-Van Heusen	5.29
8	–	Leslie Fay[1]	5.28
9	–	Warnaco[1]	5.05
10	–	Farley/Northwest Ind.[2]	4.96

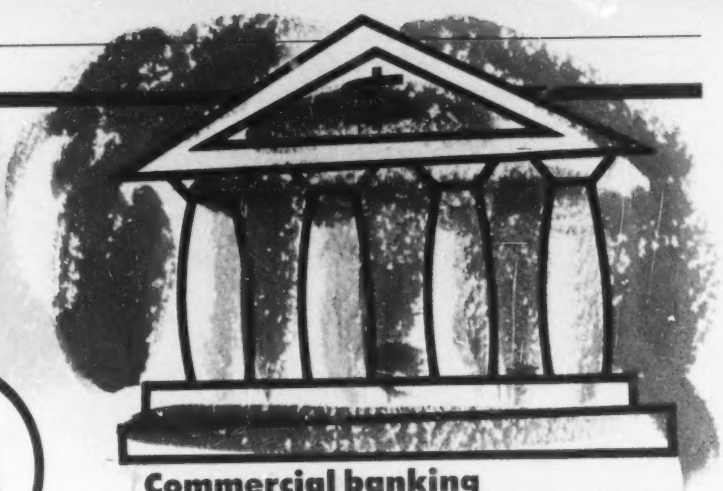
[1]Not ranked last year.
[2]Name changed to Fruit of the Loom; was No. 5 in metals last year.



Chemicals

Du Pont was tops in six categories, but Dow ranked highest in the industry for its quality of management.

RANK	LAST YEAR	COMPANY	SCORE
1	1	Du Pont	7.73
2	2	Dow Chemical	7.53
3	–	Bayer USA[1]	6.46
4	6	American Cyanamid	6.45
5	3	Monsanto	6.38
6	7	BASF	6.28
7	5	Hoechst Celanese[2]	6.05
8	8	FMC	5.41
9	9	W.R. Grace	5.12
10	10	Union Carbide	4.77



Commercial banking

J.P. Morgan rules the roost in this industry at a time when most banks are socking away reserves against bad LDC loans.

RANK	LAST YEAR	COMPANY	SCORE
1	1	J.P. Morgan	8.03
2	3	Bankers Trust New York	7.08
3	2	Citicorp	7.06
4	–	Wells Fargo & Co.[1]	6.92
5	4	Security Pacific	6.76
6	5	First Interstate Bancorp	5.91
7	7	Chase Manhattan	5.48
8	6	Chemical New York	5.41
9	8	Manufacturers Hanover	4.68
10	10	BankAmerica	3.21

Diversified financial

Even before the crash, the brokers were pulling in their horns; only American Express gets more respect than last year.

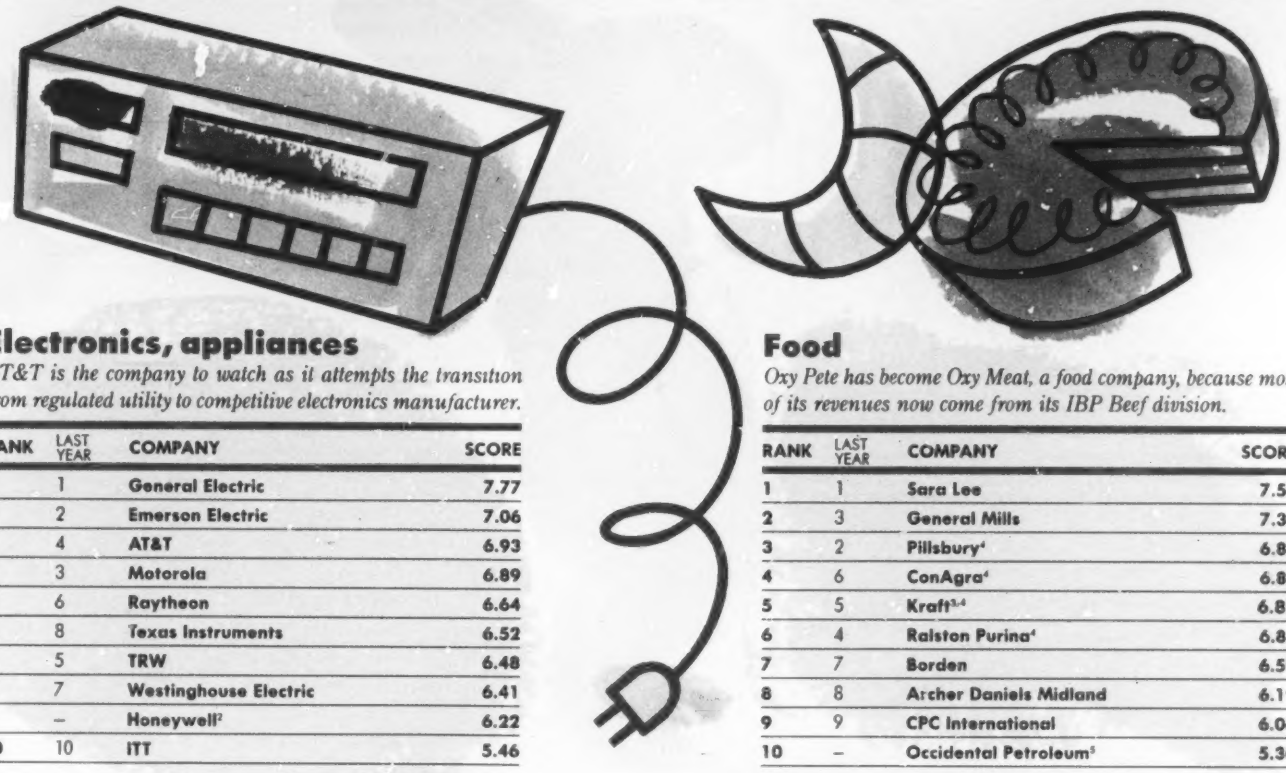
RANK	LAST YEAR	COMPANY	SCORE
1	1	American Express	7.38
2	–	Morgan Stanley Group[1]	7.01
3	2	First Boston	6.84
4	–	Salomon[3]	6.69
5	4	Bear Stearns	6.46
6	6	Aetna Life & Casualty	6.21
7	7	Travelers	6.05
8	5	Merrill Lynch	5.94
9	9	Cigna	5.73
10	8	Federal National Mortgage Ass'n.	5.50

[1]Not ranked last year.
[2]American Hoechst (not ranked last year) merged with Celanese (No. 5 last year).
[3]No. 1 in diversified service last year.
[4]No. 5 in metal products last year; it used to be American Can.

Diversified service

When Primerica was American Can, it was fifth in metal products; after a name and category change, it is No. 2.

RANK	LAST YEAR	COMPANY	SCORE
1	–	Electronic Data Systems[1]	7.09
2	–	Primerica[4]	6.75
3	4	McKesson	6.48
4	2	Super Valu Stores	6.40
5	–	Alco Standard[1]	6.03
6	5	Fleming	5.93
7	3	Hospital Corp. of America	5.77
8	10	CBS	5.68
9	9	Fluor	5.48
10	–	National Intergroup[1]	5.32



Electronics, appliances

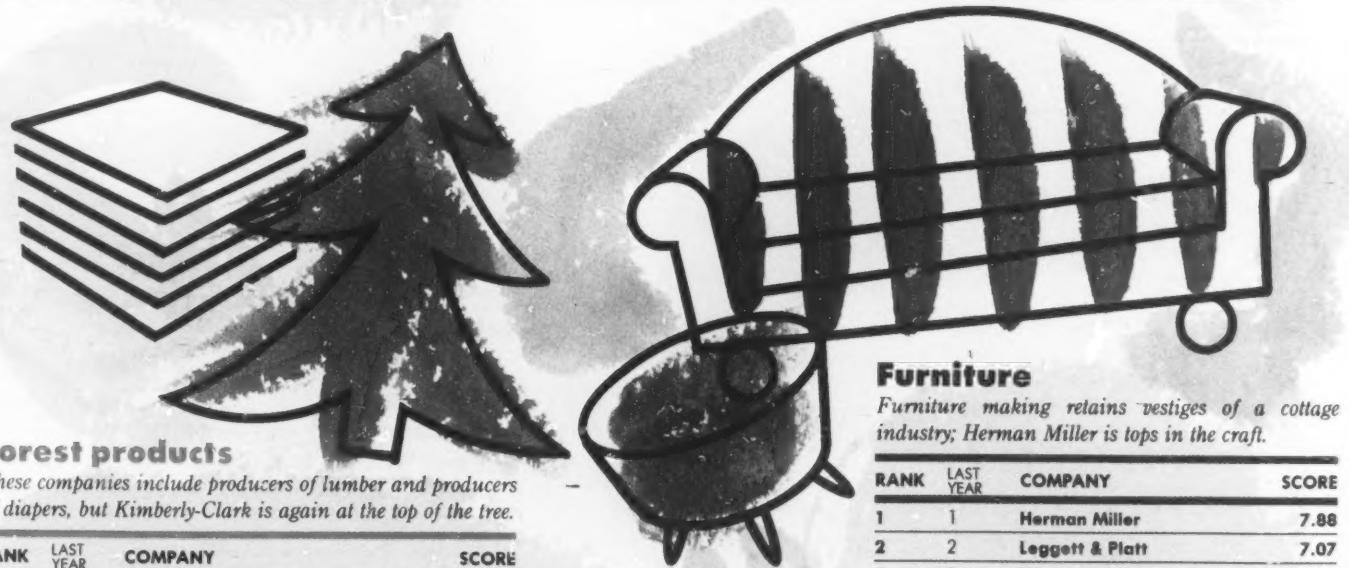
AT&T is the company to watch as it attempts the transition from regulated utility to competitive electronics manufacturer.

RANK	LAST YEAR	COMPANY	SCORE
1	1	General Electric	7.77
2	2	Emerson Electric	7.06
3	4	AT&T	6.93
4	3	Motorola	6.89
5	6	Raytheon	6.64
6	8	Texas Instruments	6.52
7	5	TRW	6.48
8	7	Westinghouse Electric	6.41
9	–	Honeywell[2]	6.22
10	10	ITT	5.46

Food

Oxy Pete has become Oxy Meat, a food company, because most of its revenues now come from its IBP Beef division.

RANK	LAST YEAR	COMPANY	SCORE
1	1	Sara Lee	7.50
2	3	General Mills	7.30
3	2	Pillsbury[4]	6.82
4	6	ConAgra[4]	6.82
5	5	Kraft[3,4]	6.81
6	4	Ralston Purina[4]	6.81
7	7	Borden	6.59
8	8	Archer Daniels Midland	6.19
9	9	CPC International	6.06
10	–	Occidental Petroleum[5]	5.30



Forest products

These companies include producers of lumber and producers of diapers, but Kimberly-Clark is again at the top of the tree.

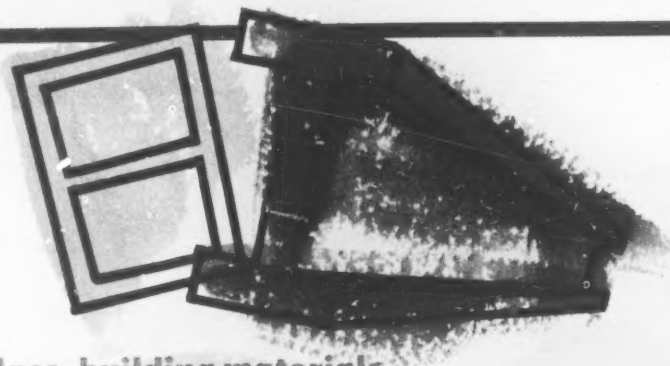
RANK	LAST YEAR	COMPANY	SCORE
1	1	Kimberly-Clark	7.40
2	3	Scott Paper	6.73
3	–	Union Camp[1]	6.69
4	2	James River Corp. of Virginia	6.48
5	4	Mead	6.35
6	5	Georgia-Pacific	6.24
7	8	Weyerhaeuser	6.17
8	7	Boise Cascade	6.06
9	9	Champion International	5.74
10	10	International Paper	5.29

Furniture

Furniture making retains vestiges of a cottage industry; Herman Miller is tops in the craft.

RANK	LAST YEAR	COMPANY	SCORE
1	1	Herman Miller	7.88
2	2	Leggett & Platt	7.07
3	3	Hon Industries	6.33
4	–	Basset Furniture[1]	6.13
5	4	Mohasco	5.95

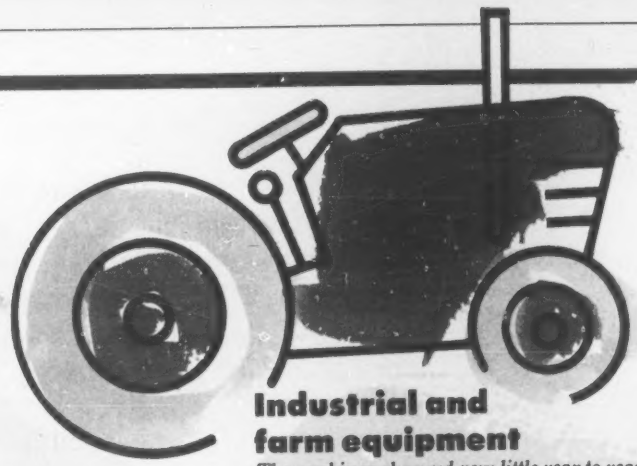
[1]Not ranked last year.
[2]No. 8 in computers, office equipment last year.
[3]Formerly Dart & Kraft.
[4]Tie.
[5]No. 7 in mining, crude-oil production last year.



Glass, building materials

Many companies have been recapitalized, taken over, or taken private, but Corning remains No. 1.

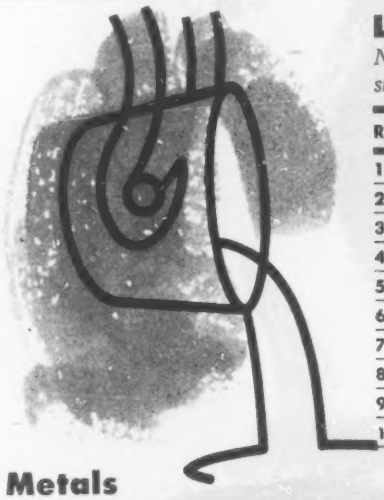
RANK	LAST YEAR	COMPANY	SCORE
1	1	Corning Glass Works	7.24
2	2	PPG Industries	7.09
3	4	USG	6.27
4	6	Owens-Corning Fiberglas	6.12
5	3	Owens-Illinois	6.09
6	7	Norton	6.05
7	8	Jim Walter	5.92
8	–	Certainteed[1]	5.78
9	9	National Gypsum	5.69
10	10	Manville	4.14



Industrial and farm equipment

The rankings changed very little year to year for these companies, but their average scores declined.

RANK	LAST YEAR	COMPANY	SCORE
1	1	Cummins Engine	6.76
2	2	Teledyne	6.69
3	3	Black & Decker	6.62
4	4	Caterpillar	6.59
5	–	Brunswick[1]	6.35
6	5	Deere	6.33
7	7	Ingersoll-Rand	6.06
8	6	American Standard[3]	5.77
9	9	Dresser Industries[3]	5.77
10	10	Baker Hughes[2]	5.76



Life insurance

Northwestern Mutual leads in management and financial strength, but Prudential gets the palm for innovation.

RANK	LAST YEAR	COMPANY	SCORE
1	1	Northwestern Mutual Life	7.03
2	2	Prudential	6.61
3	4	Aetna Life	6.44
4	6	Metropolitan Life	6.36
5	7	Connecticut General Life	6.15
6	5	Travelers	6.12
7	9	John Hancock Mutual	5.97
8	10	Equitable Life Assurance	5.89
9	3	Teachers Insurance & Annuity	5.85
10	8	New York Life	5.83

Metal products

Illinois Tool Works displaced Gillette, whose scores dropped in management and financial soundness.

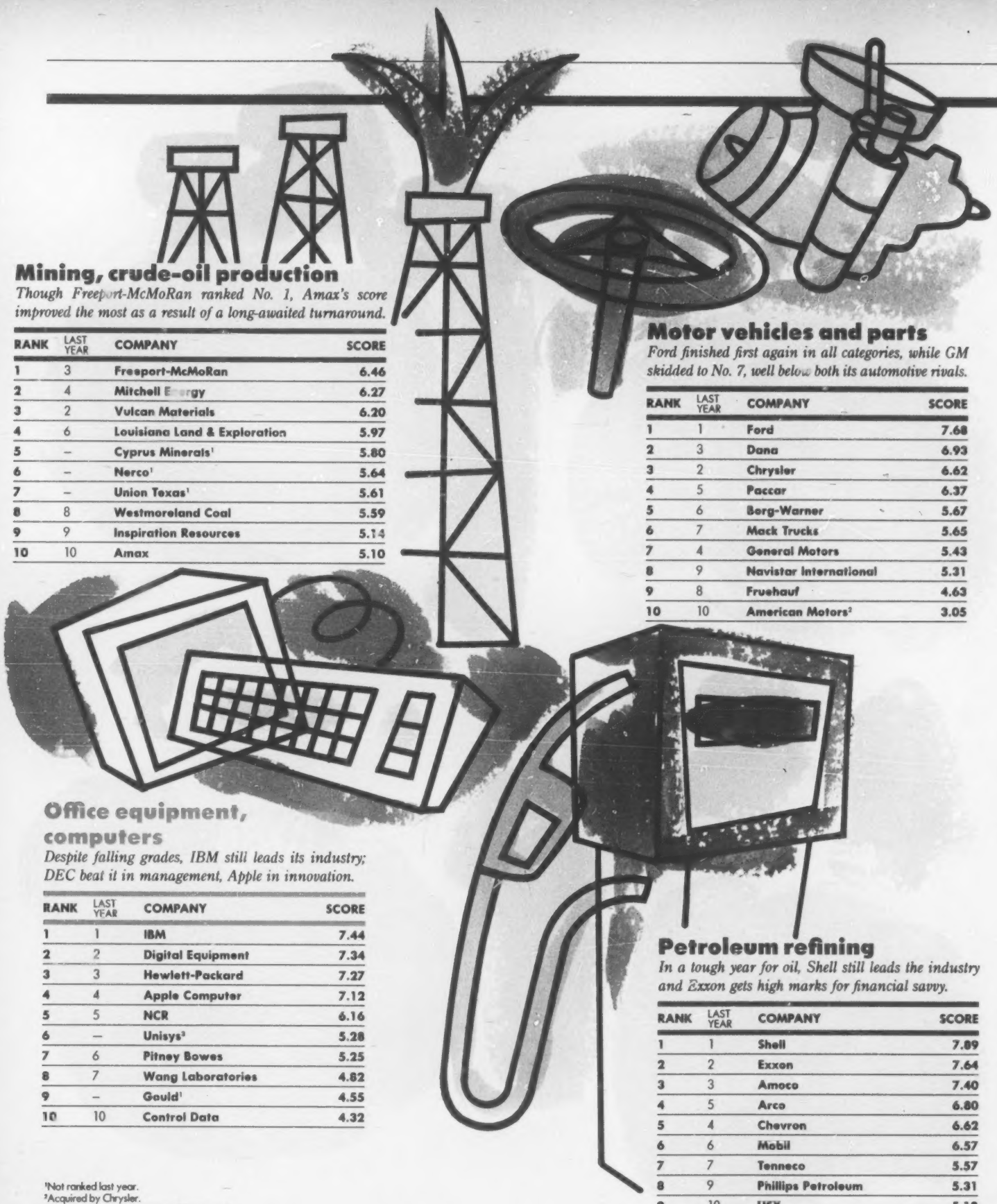
RANK	LAST YEAR	COMPANY	SCORE
1	–	Illinois Tool Works[1]	7.31
2	3	Masco	7.21
3	2	Stanley Works	6.99
4	1	Gillette	6.73
5	–	Ball[1]	6.62
6	7	Crown Cork & Seal	6.59
7	6	Emhart	6.37
8	10	Triangle Industries	5.96
9	–	Combustion Engineering[4]	5.95
10	–	Household Manufacturing[5]	5.89

Metals

Alcoa has been No. 1 in this group every year since 1983; now many of these companies are benefiting from restructuring.

RANK	LAST YEAR	COMPANY	SCORE
1	1	Alcoa	6.46
2	2	Reynolds Metals	6.42
3	–	Alumax[1]	5.69
4	6	Inland Steel	5.32
5	4	Penn Central	5.31
6	–	Cyclops[1]	4.84
7	8	Armco	4.74
8	7	Kaiser Aluminum & Chemical	4.19
9	9	Bethlehem Steel	3.69
10	10	LTV	3.24

[1]Not ranked last year.
[2]Baker International (No. 10 last year in industrial and farm equipment) merged with Hughes Tool.
[3]Tie.
[4]No. 8 in industrial and farm equipment last year.
[5]Wholly owned by Household International, No. 9 in retailing last year.



Mining, crude-oil production

Though Freeport-McMoRan ranked No. 1, Amax's score improved the most as a result of a long-awaited turnaround.

RANK	LAST YEAR	COMPANY	SCORE
1	3	Freeport-McMoRan	6.46
2	4	Mitchell Energy	6.27
3	2	Vulcan Materials	6.20
4	6	Louisiana Land & Exploration	5.97
5	–	Cyprus Minerals[1]	5.80
6	–	Nerco[1]	5.64
7	–	Union Texas[1]	5.61
8	8	Westmoreland Coal	5.59
9	9	Inspiration Resources	5.14
10	10	Amax	5.10

Motor vehicles and parts

Ford finished first again in all categories, while GM skidded to No. 7, well below both its automotive rivals.

RANK	LAST YEAR	COMPANY	SCORE
1	1	Ford	7.68
2	3	Dana	6.93
3	2	Chrysler	6.62
4	5	Paccar	6.37
5	6	Borg-Warner	5.67
6	7	Mack Trucks	5.65
7	4	General Motors	5.43
8	9	Navistar International	5.31
9	8	Fruehauf	4.63
10	10	American Motors[2]	3.05

Office equipment, computers

Despite falling grades, IBM still leads its industry; DEC beat it in management, Apple in innovation.

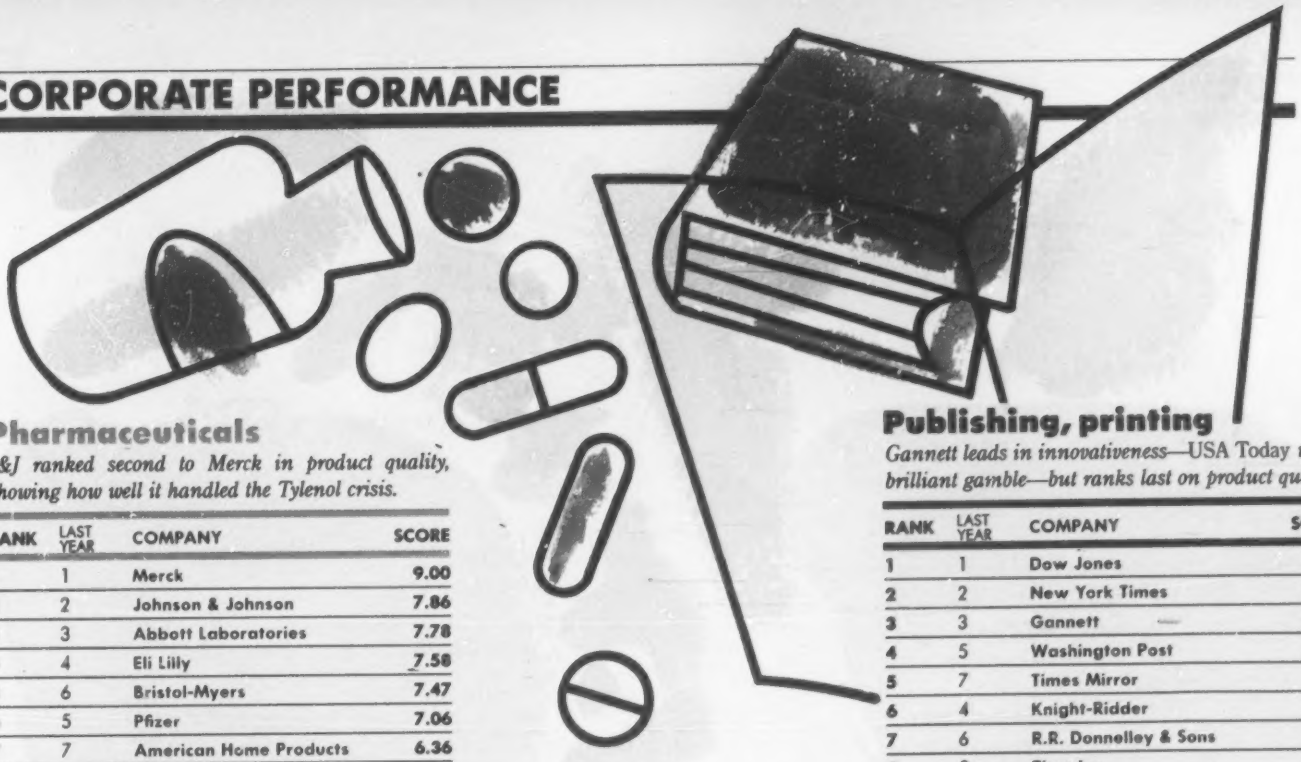
RANK	LAST YEAR	COMPANY	SCORE
1	1	IBM	7.44
2	2	Digital Equipment	7.34
3	3	Hewlett-Packard	7.27
4	4	Apple Computer	7.12
5	5	NCR	6.16
6	–	Unisys[3]	5.28
7	6	Pitney Bowes	5.25
8	7	Wang Laboratories	4.82
9	–	Gould[1]	4.55
10	10	Control Data	4.32

Petroleum refining

In a tough year for oil, Shell still leads the industry and Exxon gets high marks for financial savvy.

RANK	LAST YEAR	COMPANY	SCORE
1	1	Shell	7.89
2	2	Exxon	7.64
3	3	Amoco	7.40
4	5	Arco	6.80
5	4	Chevron	6.62
6	6	Mobil	6.57
7	7	Tenneco	5.57
8	9	Phillips Petroleum	5.31
9	10	USX	5.18
10	8	Texaco	4.75

[1]Not ranked last year.
[2]Acquired by Chrysler.
[3]Company formed by merger of Sperry and Burroughs (No. 9 last year).



Pharmaceuticals

J&J ranked second to Merck in product quality, showing how well it handled the Tylenol crisis.

RANK	LAST YEAR	COMPANY	SCORE
1	1	Merck	9.00
2	2	Johnson & Johnson	7.86
3	3	Abbott Laboratories	7.78
4	4	Eli Lilly	7.58
5	6	Bristol-Myers	7.47
6	5	Pfizer	7.06
7	7	American Home Products	6.36
8	9	Baxter Travenol	6.34
9	10	Warner-Lambert	6.29
10	8	SmithKline Beckman	6.06

Publishing, printing

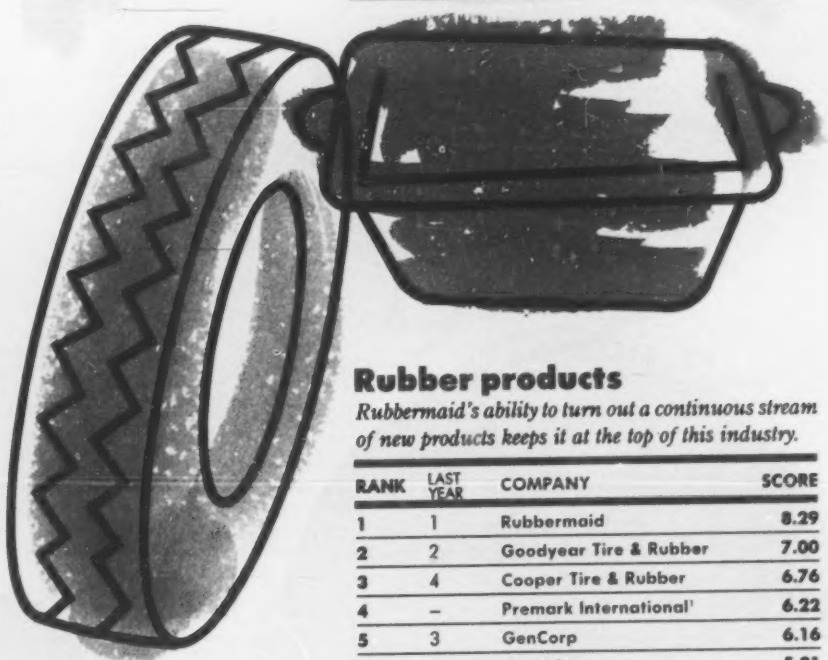
*Gannett leads in innovativeness—*USA Today *was a brilliant gamble—but ranks last on product quality.*

RANK	LAST YEAR	COMPANY	SCORE
1	1	Dow Jones	8.24
2	2	New York Times	7.74
3	3	Gannett	7.29
4	5	Washington Post	7.22
5	7	Times Mirror	7.12
6	4	Knight-Ridder	7.04
7	6	R.R. Donnelley & Sons	7.03
8	8	Time Inc.	6.86
9	10	Tribune	6.70
10	9	McGraw-Hill	6.36

Retailing

Neither Wal-Mart nor May was ranked last year, but they're in fashion now. Sears has taken a tumble.

RANK	LAST YEAR	COMPANY	SCORE
1	–	Wal-Mart Stores[1]	7.90
2	–	May Department Stores[1]	6.38
3	4	J.C. Penney	6.33
4	3	Kroger	5.97
5	6	K mart	5.89
6	2	Sears Roebuck	5.85
7	8	American Stores	5.65
8	5	Federated Dept. Stores	5.61
9	7	Southland	5.24
10	–	Safeway Stores[1]	4.75

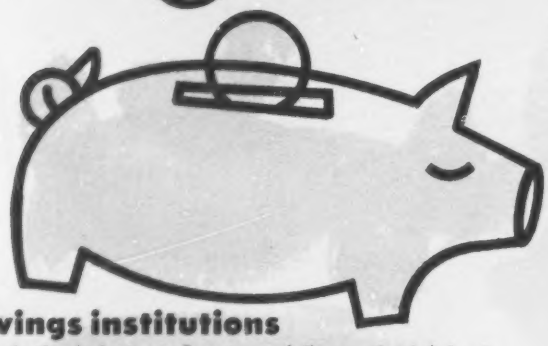


Rubber products

Rubbermaid's ability to turn out a continuous stream of new products keeps it at the top of this industry.

RANK	LAST YEAR	COMPANY	SCORE
1	1	Rubbermaid	8.29
2	2	Goodyear Tire & Rubber	7.00
3	4	Cooper Tire & Rubber	6.76
4	–	Premark International[1]	6.22
5	3	GenCorp	6.16
6	6	Armtek[4]	5.81
7	7	Firestone Tire & Rubber	5.66
8	8	B.F. Goodrich	5.64
9	9	Dorsey[2]	5.42
10	10	Dayco[3]	5.10

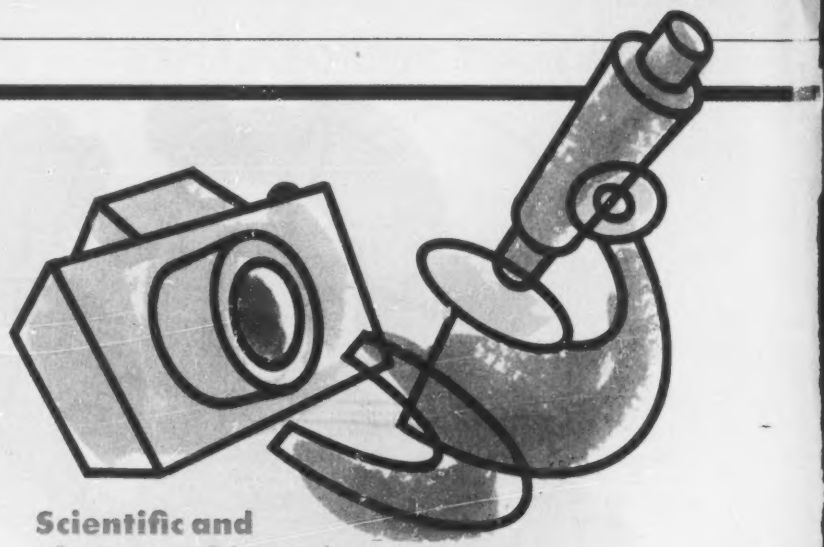
[1]Not ranked last year.
[2]Name changed to Constar.
[3]Name changed to DAY International.
[4]Name changed from Armstrong Rubber.



Savings institutions

Though the industry seems perennially on the brink of disaster, Great Western maintains its leadership.

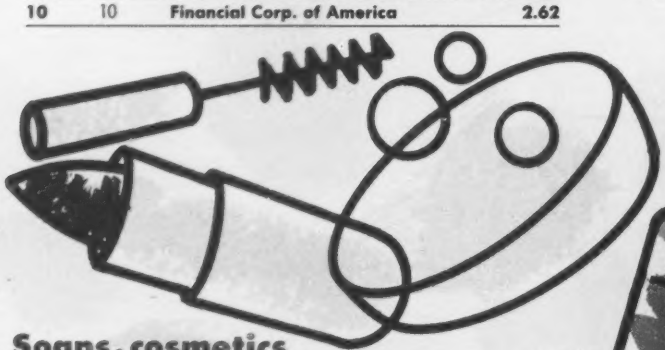
RANK	LAST YEAR	COMPANY	SCORE
1	1	Great Western Financial	7.59
2	2	H.F. Ahmanson	7.14
3	4	Golden West Financial	6.84
4	3	Home Federal Savings & Loan	6.48
5	–	Great American First Savings[1]	6.14
6	5	Calfed	5.97
7	6	Glenfed	5.80
8	8	Meritor Financial Group	4.56
9	9	Gibraltar Financial	4.36
10	10	Financial Corp. of America	2.62



Scientific and photographic equipment

Xerox and Polaroid, companies that created industries and then seemed to lose their way, are again gaining respect.

RANK	LAST YEAR	COMPANY	SCORE
1	1	3M	8.10
2	2	Eastman Kodak	7.32
3	6	Xerox	6.66
4	7	Polaroid	6.53
5	3	EG&G	6.44
6	5	Becton Dickinson	6.27
7	4	Perkin-Elmer	6.17
8	8	Tektronix	6.14
9	10	Lear Siegler	5.55
10	9	General Signal	5.49



Soaps, cosmetics

P&G cleaned up in every category. IFF had the second-highest point gain, up 12%, of all the companies in the survey.

RANK	LAST YEAR	COMPANY	SCORE
1	1	Procter & Gamble	8.15
2	4	International Flavors & Fragrances	7.30
3	5	Colgate-Palmolive	6.98
4	2	Lever Brothers	6.97
5	3	Clorox	6.70
6	6	Chesebrough-Pond's	6.44
7	7	Avon Products	6.24
8	8	Ecolab[2]	5.92
9	–	Alberto-Culver[1]	5.53
10	9	Revlon Group	5.42

Textiles

Armstrong World Industries rose two notches, while Collins & Aikman, the former leader, tumbled to fifth place.

RANK	LAST YEAR	COMPANY	SCORE
1	3	Armstrong World Industries	7.27
2	2	West Point–Pepperell	7.09
3	4	Springs Industries	7.06
4	5	Shaw Industries	6.78
5	1	Collins & Aikman	6.33
6	7	J.P. Stevens	6.24
7	6	Fieldcrest Cannon	6.21
8	9	DWG	5.24
9	8	Burlington Industries	4.82
10	10	United Merchants & Mfrs.	4.68

[1]Not ranked last year.
[2]Name changed from Economics Laboratory.

Tobacco

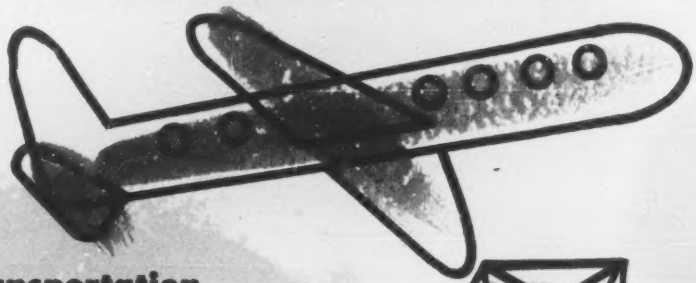
Philip Morris changed places with RJR Nabisco, and both are admired for diversifying away from smokes.

RANK	LAST YEAR	COMPANY	SCORE
1	2	Philip Morris	8.07
2	1	RJR Nabisco	7.90
3	3	United States Tobacco	6.63
4	4	American Brands	6.45

Toys, sporting goods

There just hasn't been a blockbuster toy this year, but even so Hasbro remains king of the sandbox.

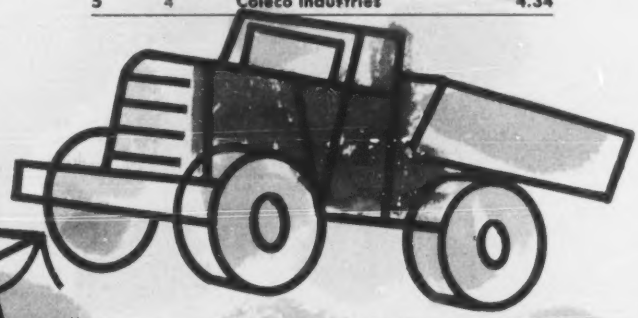
RANK	LAST YEAR	COMPANY	SCORE
1	1	Hasbro	7.05
2	–	Kenner Parker Toys[1]	5.95
3	2	Mattel	5.41
4	3	Minstar	5.06
5	4	Coleco Industries	4.34



Transportation

UPS delivers the goods again. Allegis and Texas Air got bad marks on management and service.

RANK	LAST YEAR	COMPANY	SCORE
1	1	United Parcel Service	7.30
2	2	AMR	6.84
3	3	Delta Air Lines	6.42
4	4	Norfolk Southern	6.34
5	–	Union Pacific[2]	6.24
6	7	Burlington Northern	5.87
7	6	CSX	5.70
8	8	Santa Fe Southern Pacific	5.04
9	5	Allegis[3]	4.70
10	–	Texas Air[1]	4.00



Transportation equipment

Fleetwood leads in financial soundness and innovativeness while Harsco is tops as an investment.

RANK	LAST YEAR	COMPANY	SCORE
1	1	Fleetwood Enterprises	7.07
2	–	Harsco[4]	7.04
3	–	Trinity Industries[1]	6.94
4	–	International Controls[1]	5.67

Utilities

So far the Baby Bells have done better on their own than Ma has. Bell Atlantic rates high in management and service.

RANK	LAST YEAR	COMPANY	SCORE
1	2	Bell Atlantic	7.46
2	1	BellSouth	7.45
3	3	Ameritech	7.33
4	5	Nynex	7.17
5	4	Pacific Telesis Group	6.96
6	6	US West	6.86
7	7	Southwestern Bell	6.80
8	8	Pacific Gas & Electric	6.42
9	9	Southern	6.23
10	10	GTE	6.07

[1]Not ranked last year.
[2]No. 6 in diversified service last year.
[3]Name changed from UAL.
[4]No. 8 in metal products last year.

A REPORT CARD ON REAGAN

With a year to go, he has flunked the course in budget balancing but has scored three unequivocal successes. And his Russian seminar with Gorbachev looks promising. ■ *by Lee Smith*

AS RONALD REAGAN starts his last year in office, the time is right for a preliminary accounting of his legacy. Reagan's presidency is particularly hard to assess because it is filled with paradoxes. He portrays himself as a fiscal conservative who would just love a constitutional amendment barring deficits. But the government has run up the biggest debt ever during his seven years. He has been among the most strident of anti-Communists. Yet he has just signed one nuclear arms reduction treaty with the Soviet Union and may well complete a more sweeping agreement before he leaves office. He has presided over the longest peacetime economic expansion —and the deepest stock market plunge.

Paradoxes aside, Reagan has had three unequivocal triumphs. He helped beat down inflation. He made the military strong again. He restored the authority of the presidency and American self-respect. Add to that tax reform, though not without a few asterisks. Reagan's reductions in marginal tax rates, starting with the 1981 cuts and culminating in the Tax Reform Act of 1986, lowered the maximum personal rate from 70% to 28% and inspired a worldwide movement away from sky-high rates designed to redistribute wealth. Faster growth has resulted in country after country—including the U.S. But the 1986 law shifted some of the tax burden to business, a certain crimp in investment. In addition, Reagan's first cuts never generated the growth his supply-siders promised, and he failed to offset revenue losses with spending reductions.

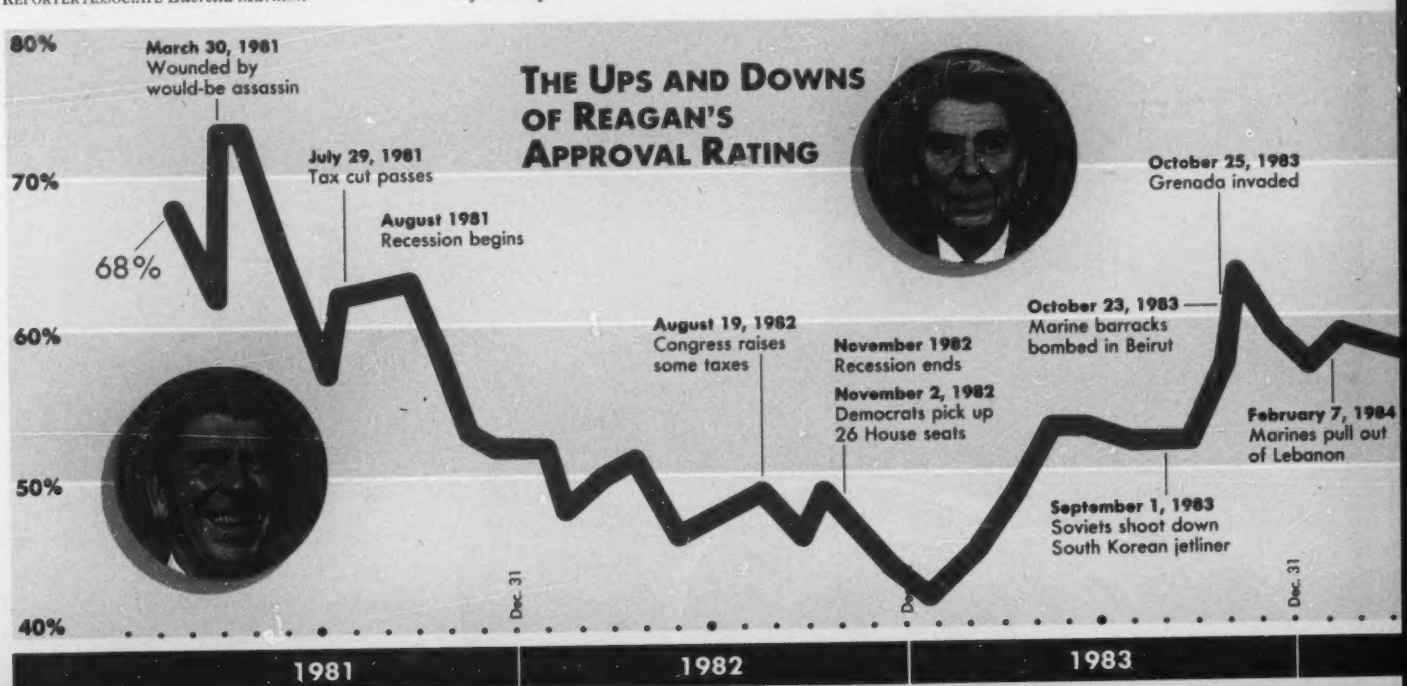
The final grades for the Reagan era won't be available until years after he leaves office. Many big bills Lyndon Johnson's Great Society ran up didn't arrive until the late 1970s. Who can say with certainty, for example, whether Reagan's intransigence in dealing with the Sandinistas will poison relations with Central America or turn out to be a kind of "tough love" that the region ultimately will appreciate?

The agreement Reagan just made with Mikhail Gorbachev to eliminate intermediate- and short-range missiles in Europe is another of those events that need historic perspective to evaluate fully. But certainly it belongs on the positive side of Reagan's ledger.

Unlike his immediate predecessors, Reagan aroused and led the country, although much more persuasively before the Iran-contra affair than after. Along with Britain's Margaret Thatcher, he set an agenda that emphasized reliance on market forces rather than the clumsy hand of centralized economic control.

He restored much of the presidency's tra-

REPORTER ASSOCIATE *Lucretia Marmon*



ditional power as a bully pulpit. While others seemed stooped by the weight of the office, Reagan has liked the heft of it from his first day in the White House, refusing to let anything depress him for long. Who can forget Reagan's jaunty quips as he was wheeled into surgery after being shot by a would-be assassin? By word and example he convinced the U.S. all over again that it is a "can do" country.

Recall the national despair of 1980. An attempt to rescue American hostages from the U.S. embassy in Tehran crumbled in the Iranian desert. As for the economy, a cartoon that year said it all: A frantic shopper raced up and down the aisles of a supermarket trying to get ahead of the clerk who was stamping higher prices on every item in the store. The inflation rate was about 12% on election day.

Some 43 million shoppers voted for Reagan. By 1983 inflation was down to 4.1%, to the astonishment of the many economists who thought such a reduction would take a decade or more. The conqueror was, of course, Federal Reserve Chairman Paul Volcker, who drastically cut the money supply. But Volcker also got help from Reagan. Officially the President has no authority to tell the Fed what to do, but Reagan was free to go on television and tell the nation the Fed was strangling the economy. If he had, even Volcker's iron will might have suffered a bit of metal fatigue. Says Lyle Gramley, a governor of the Fed at the time: "Volcker appreciated the President's support."

	1980	1987	PERCENT CHANGE
Inflation	9.9%	3.3%	−71%
Employment in millions	99	113	+14%
Army recruits with high school diplomas	56%	91%	+61%
Savings as a percent of personal income	7.1%	3.4%	−52%
Budget deficit in billions	$73.8	$148	+50%
Trade deficit in billions	$36	$175	+386%
Farm subsidies in billions	$2.8	$22.4	+711%

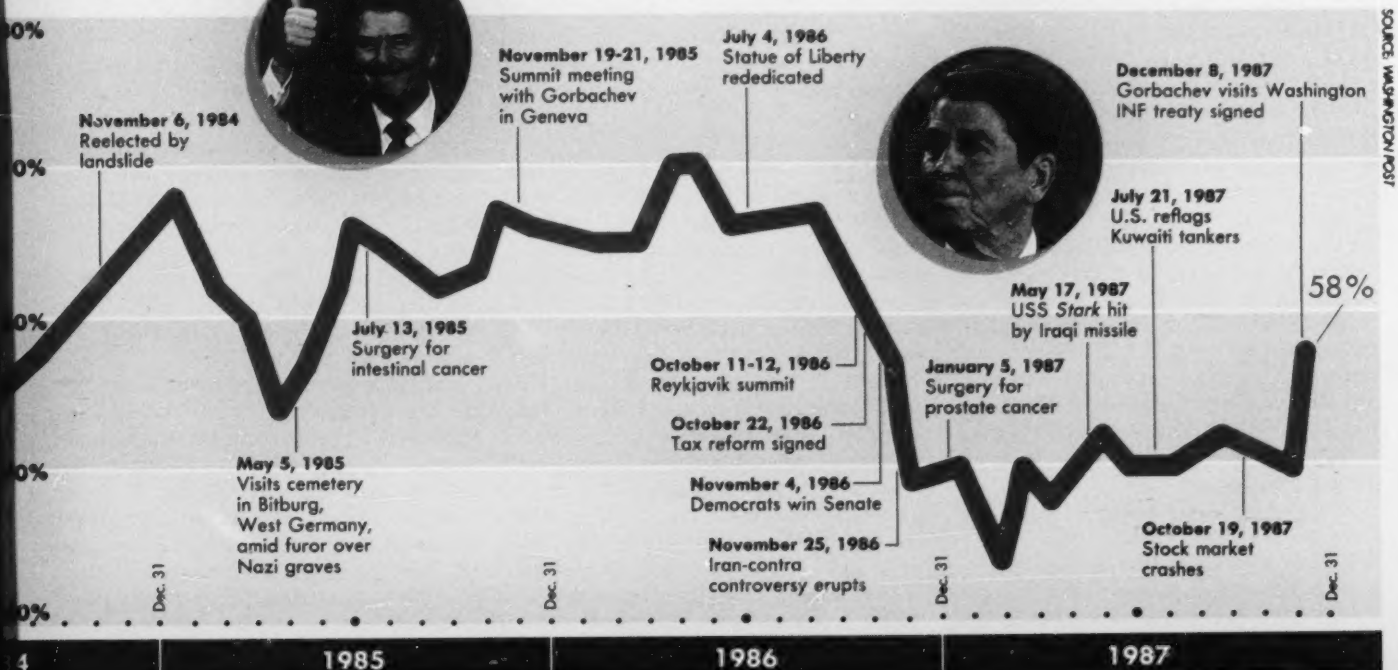
Some Good News . . . and Bad

Inflation dropped dramatically, millions of jobs were created, and Army recruits got smarter. But the trade and budget deficits grew into the twin towers. And saving money went out of style.

Reagan's other blow against inflation—the firing of 11,300 air traffic controllers in August 1981—was more impressive. Says Murray Weidenbaum, the first chairman of Reagan's Council of Economic Advisers: "Previous Administrations typically would get involved in important strikes and push for a quick resolution, which generally meant an expensive settlement." The controller confrontation made clear that Reagan would not urge employers to settle at any price. Wage and salary increases have been modest during the Reagan years—an average of 4.9% annually—and the amount of work that didn't get done because of strikes and lockouts fell from 21 million days in 1980 to about five million in 1987.

The third big success of Reagan's first term was strengthening defense. In the 1970s the country, sick of war, carelessly turned its back on its soldiers. Defense budgets dwindled from 6.9% of GNP in 1972, the last big-spending year of the Vietnam era, to 5% in 1980. Pressed for cash, the Pentagon cut back on banal but essential items like ammunition and training. Military pay fell so far behind civilian wages that the Pentagon had to flesh out the ranks with a raffish lot of high school dropouts. On some bases they were such a loutish crew that officers kept them in the background when Defense Secretary Harold Brown made inspection tours.

By the time Reagan entered the White House, Congress was ready to oblige his campaign promise of a military buildup. Even Carter had belatedly recognized, after the Soviet invasion of Afghanistan in December 1979, that the services had been neglected. He asked for an increase of 5.4% above inflation in the last defense budget he submitted. Congress added 3.6% to that, gave Reagan the 3% extra he asked for, and continued to increase military spending for the next four years, largess never before seen in peace-



SOURCE: WASHINGTON POST

PHOTOGRAPHS BY: (FROM LEFT TO RIGHT) MICHAEL EVANS—SYGMA; DAVID HUME KENNERLY; DAVID HUME KENNERLY; DIANA WALKER

time. From 1982 through 1986 the Pentagon received more than $1.4 trillion, or 38% more than it had in the previous five years after adjusting for inflation.

The U.S. has doubled the number of trucks and tanks and the amount of ammunition stockpiled in Europe. The Navy has 563 ships, 84 more than it had seven years ago. The latest model tanks and planes in the arsenal can strike far more devastating blows than their predecessors. The most remarkable advance in defense, and the one least noticed, is that 91% of Army recruits come equipped with high school diplomas, compared with only 56% in 1980. The new troops are smart enough to use their smart weapons. Once widespread, drug use and brawling have ceased to be serious problems.

REAGAN DESERVES the credit. He helped revive respect for the uniform and won the soldiers more money. Supreme Court Justice Thurgood Marshall and others have castigated Reagan for indifference to minorities. Yet blacks and Hispanics make up almost a quarter of the military population, so the pay increase has put a lot of money into the pockets of people Marshall is concerned about.

When it comes to taxes, Paul Craig Roberts, a supply-side economist who was an assistant treasury secretary in the early 1980s, waxes ecstatic as he contemplates what has transpired. "Property rights have been greatly expanded," he says, "and when that happens without guns it's extraordinary." In the Middle Ages serfs generally paid no more than a third of their incomes in taxes, so in Roberts's view Americans have risen from worse than serfdom to serfdom. For all the hyperbole, Roberts has a point. Americans generally have a greater stake in what they earn.

Those at the bottom of the tax scale got a big break from the tax law of 1986. "Tax reform is the one new antipoverty program of the Eighties," says Sheldon Danziger, director of the University of Wisconsin's Institute for Research on Poverty. A divorced woman, say, supporting a child on a taxable income of $10,000 a year, paid as much as $900 in taxes under the old law. This year no one caring for a child or other dependent on such an income will pay a cent.

Business taxes, however, are going up. Over the next five years the 1986 law will shift about $120 billion in taxes from individuals to corporations. Some of that will get passed on to consumers—a regressive tax. The rest will hit capital, reducing investment and the benefits that flow from it.

The greatest failure of the Reagan years has been his cavalier attitude toward spending. The $1 trillion budget that the President submits to Congress in January is about 16% higher in constant 1982 dollars than Carter's last. Congress could have curbed spending, of course. Still, the tragedy of the Reagan years is that he started with a mandate to cut spending but squandered it by not taking tough decisions, as in the case of Social Security.

Most citizens didn't worry about deficit spending because Reagan didn't worry. Jerry Jordan, a member of Reagan's Council of Economic Advisers in 1981 and 1982, argues that no Democratic President would have been allowed to run up such deficits. Americans handed Reagan a platinum credit card for the same reason they let Nixon deal with China, says Jordan. Republicans are anti-Communist and won't be gulled. Republicans are financially responsible and won't splurge with plastic.

SUPPLY-SIDERS on the Reagan team maintained that the cut in tax rates would toss so much fertilizer on the economy that new revenues would sprout, more than making up for the cuts. They still argue that the strategy would have worked if Volcker hadn't been so stingy with water. Tightening the tap on the money supply threw the economy into recession. The supply-siders have a point, but Volcker concentrated on the most immediate problem, inflation, and he was right in doing so.

The correct answer to closing the deficit was simple but painful: Cut spending. That Reagan refused to do. Carter's deficit of $73 billion in 1980 was considered scandalous. By 1986 the deficit was three times as large, and the adjectives were exhausted. A few blunders stand out as especially egregious:

▶ **Blunder 1.** Reagan paid tens of billions too much for the military muscle he bought. The money came in greater gobs than the generals and admirals could spend wisely. Each service asked for whatever it thought it needed to whip the Russians, as though it would have to do the job alone. The prime example was the Navy, which before Reagan had two major tasks in the event of war: Protect sea lanes with its 12 aircraft carrier groups, and fire nuclear missiles at the Soviet Union from submarines. Navy Secretary John Lehman promoted an additional mission: the so-called forward strategy of launching bombers from carriers to attack Soviet land bases in Murmansk and Vladivostok. To carry out that new mission, Lehman persuaded Reagan to expand the number of carrier groups from 12 to 15.

But many defense experts, including former Navy men, maintain that the strategy won't work because it would take at least 20 groups, not 15, for the Navy to protect the sea lanes and assault Soviet bases at the same time. So the addition of three carrier groups slips between the slats: too few carriers to attack the Soviet Union, more than enough for guard duty and occasional flash crises off the coast of Libya and elsewhere.

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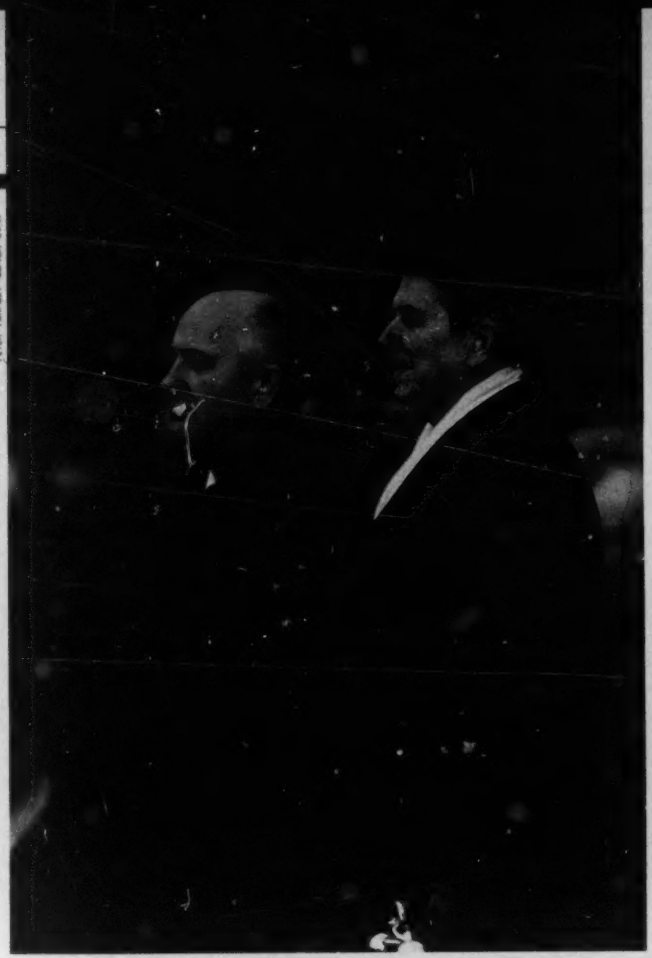


PETER TURNLEY—BLACK STAR

At the next summit, *in Moscow, Reagan will need patience.*

The expense is huge. Each extra carrier group, complete with 90 or more planes and eight to ten escort ships, runs about $18 billion, not including fuel and pay for 7,000 crew members.

▶ **Blunder 2.** Reagan passed up opportunities to control Social Security expenses. In 1985 Senate Republicans, at the risk of infuriating elderly voters, agreed to an Administration plan that would have withheld retirees' cost-of-living increases for one year. The scheme would have saved about $7 billion in the first year and about $10 billion every year after that, because future increases would have been figured on a lower base. But at the last minute Reagan changed his mind, abandoned party colleagues, and discarded the idea. Similarly, Reagan refused to put Social Security on the agenda in the budget compromise with Congress two months ago. The President should have shown the same courage he displayed in backing Volcker.

▶ **Blunder 3.** In 1985 Reagan's Agriculture Department produced a program that turned out to be the most expensive subsidy for farmers ever. To encourage exports the Administration lets farmers sell crops abroad at the market price and then pays them the difference between that and a so-called target price, an amount set at whatever Farm Belt legislators can win for their constituents. "That program has been the greatest disappointment of the Reagan Administration," says Burton Pines, a vice president of the neoconservative Heritage Foundation and an enthusiastic supporter of the President in other respects. It cost taxpayers more than $22 billion in 1987, more than eight times 1980's farm handouts.

SOME ANALYSTS see a brilliant tactician at work behind Reagan's profligacy. William Schneider, a resident fellow at the American Enterprise Institute, a centrist research organization in Washington, D.C., points out that the huge deficit has stopped the Democrats from advancing programs on their social agenda, such as national health insurance and guarantees of work for all. Reagan slowed the advance of the welfare state without direct confrontation.

Perhaps, but Reagan certainly didn't intend another side effect of the growing debt, the deepening trade deficit. And the budget deficit has held down defense expenditures since 1985 as well. Already some of the gains Reagan can be proud of are starting to slip. The number of training hours flown by fighter pilots peaked in 1985, for example, and has declined a bit. The Navy says that under its new $100 billion budget it will have to cut down on the steaming time of ships and put off some routine maintenance.

The U.S. has also sacrificed much of its economic independence. Instead of being a creditor to the world as it was in 1980, the U.S. has to borrow abroad $10 billion to $15 billion a month. Fortunately for the U.S., it owes the money in dollars, so unlike Brazil it need not buy someone else's expensive currency to settle up. Though the Japanese have been urging Washington to sell some bonds denominated in yen—which would penalize the U.S. if the yen continues to strengthen—the Treasury has so far resisted. But if interest rates are not high enough to keep attracting Japanese dollars, the U.S. may have to give in, putting the country on the scary road to quasi-Latin status.

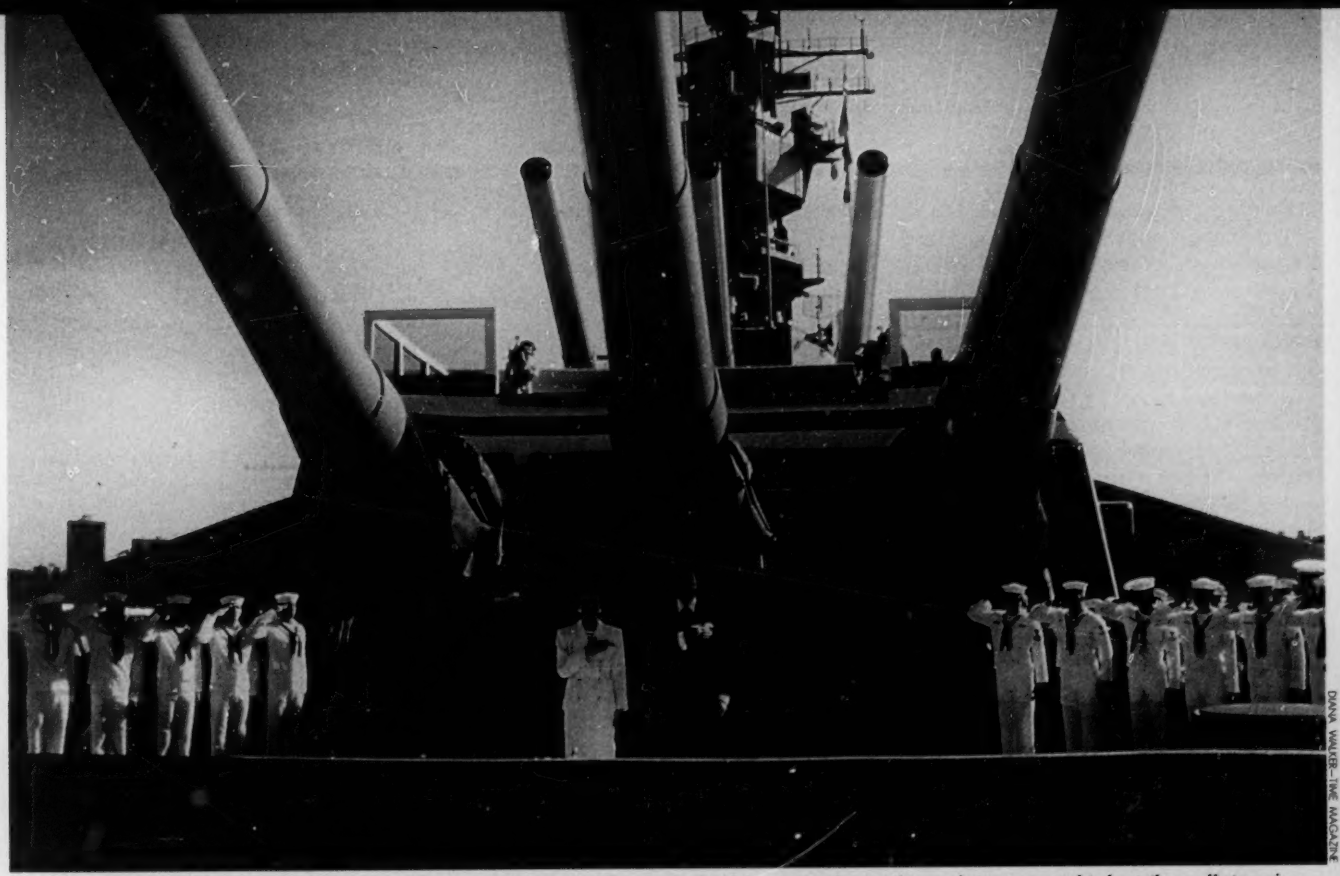
Nor did Reagan make much progress in getting government off citizens' backs. He could not advance the cause of deregulation much beyond Carter's laudable achievements of freeing airlines to fly where and charge what they want, and letting truck drivers carry loads where they like. Banks are still not allowed to compete head on with securities firms. Reagan has not lived up to his campaign promise to disband the education and energy departments either. In fact, he now wants to elevate the Veterans Administration from agency to department and thus give a seat at the Cabinet table to a pleader for more benefits for old soldiers. A White House staffer offers a cynical explanation for the principle guiding the President: "Veterans tend to vote Republican."

Reagan has slowed the rate by which the bureaucracy multiplies itself but hasn't reversed it. The number of federal employees, not counting the military, grew an average of 33,000 persons a year during the Carter Administration and 11,000 annually so far in the Reagan years. The federal government now employs 2.93 million persons outside the Pentagon, vs. 2.85 million in 1980.

Still, Reagan partly succeeded in shifting the burden of problem solving to local government. Though governors for years have led delegations abroad seeking foreign investment, the pace picked up dramatically once it sank in that there would be no big job-creation programs coming out of Reagan's Washington. Fifty-six states and port authorities have representatives in Tokyo, compared with only 12 in 1980. Harvard economist Robert Reich is not an admirer of the President but believes Reagan has forced

BRAD MARKEL—GAMMA/LIAISON

Tax reform *was a victory with an asterisk. This is the signing, with great fanfare, of the 1986 act.*



DIANA WALKER—TIME MAGAZINE

Swelling with pride *as well as ships in the Reagan buildup, the Navy is strapped for money for routine maintenance and to keep them all steaming.*

local government to be more innovative, which has in turn made city and state jobs more appealing. Says Reich: "Local government now attracts the most talented group of people since the Progressive era."

The voluntarism that Reagan has championed is on the rise as well. "People are helping other people first-hand, rather than letting government do it," says Michael Novak, who writes on religion and policy. "These will go down as the most communitarian years in decades." Contributions to charity, not counting church donations, rose dramatically from $49 billion in 1980 to $87 billion in 1986—3% a year faster than the growth of GNP. That was helped no doubt by more favorable treatment in the 1981 tax bill, but also by the sense that government was far less charitable under Reagan than in the past.

It would be hard to give Reagan or anyone else credit, but tradition and conservative values may be making a comeback. There were more marriages—and fewer divorces—in 1986 than in 1980. Education Secretary William Bennett thinks Reagan's most important contribution has been to reintroduce the concept of values—not just conservative values, but *any* values—into a society dominated by relativist thinking. "People used to feel goofy about talking about patriotism, family, self-reliance, respect for property," says Bennett. "Reagan made it okay to talk about those things."

Reagan's promotion of values is not as convincing as it used to be. In the Iran-contra scandal the President did what he said no one should ever do. He made terrorism profitable by selling arms in the hope of getting hostages. Then he was far less than straightforward about it. His reputation has rebounded, but two qualities Americans admired about him, common sense and honesty, will never look as solid again.

THE VIRTUE that could rescue him is patience. Gorbachev is itching for a 50% cutback in strategic nuclear weapons. He wants to demonstrate to the Politburo and the world that unlike his predecessors he can close a big deal with the U.S. More than that, he badly needs a break from the arms race to pour more resources into his vast reorganization of the Soviet economy. Reduction would be good for both superpowers. Provided the U.S. is allowed the right mix of sea-, land-, and air-based missiles, it will retain enough to pulverize the Soviet Union, even after a surprise attack. Yet fewer warheads would mean less chance of accidental disaster, and the U.S. and the Soviet Union would have established a precedent for resolving difficult issues without warfare.

Even so, what is more significant for the U.S., and for European and global stability, is shrinking the size of conventional armies. There is no way the U.S. can match Russia man for man. By some estimates the U.S. spends 100 times as much as the Soviet Union to equip, train, and pay a soldier. In addition, the Soviets and their allies back up their soldiers with twice as many tanks as NATO has, and almost three times as many artillery pieces. They have 201 divisions, vs. 149 for NATO. As budgetary constraints increase, the Defense Department plans to trim 100,000 troops by the mid-1990s.

What Reagan must do is persuade Gorbachev that because of the Soviet Union's huge advantage in conventional forces, any agreement for fewer nuclear warheads must be accompanied by reductions in troops. In conventional forces, the cuts cannot be one for one. The Warsaw Pact would have to demobilize far more divisions than NATO to bring the two sides into balance; five or more for every one of NATO's. Even if Gorbachev goes along, the idea won't go down easily with his field marshals. Complicated agreements to reduce nuclear and nonnuclear arms simultaneously could take years to work out. But at least Reagan can establish the basic principles and get the process started. That's not the sort of achievement that will win him a standing ovation as he leaves the stage. But it might well impress the critics who look back on this drama from the perspective of future generations. ■